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TITLE OF THESIS: STATUTORY DERIVATIVE ACTIONS: THE LOCUS STANDI OF A MINORITY SHAREHOLDER TO ENFORCE CORPORATE RIGHTS IN ALBERTA AND NIGERIA

DEGREE: MASTER OF LAWS

YEAR THIS DEGREE GRANTED: 1999

University of Alberta

STATUTORY DERIVATIVE ACTIONS: THE LOCUS STANDI OF A MINORITY SHAREHOLDER TO ENFORCE CORPORATE RIGHTS IN ALBERTA AND NIGERIA.

by

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A thesis submitted to the Faculty of Graduate Studies and Research in partial fulfilment of the requirements for the degree of Master of Laws.

Faculty of Law

Edmonton, Alberta

Fall 1999

University of Alberta

Faculty of Graduate Studies and Research

The undersigned certify that they have read, and recommend to the Faculty of Graduate Studies and Research for acceptance, a thesis entitled **STATUTORY DERIVATIVE ACTIONS: THE LOCUS STANDI OF A MINORITY SHAREHOLDER TO ENFORCE CORPORATE RIGHTS IN ALBERTA AND NIGERIA** submitted by Olumide Kolawole Obayemi in partial fulfilment of the requirements for the degree of Master of Laws.

ABSTRACT

The statutory derivative action provisions in Alberta and Nigeria were significantly and substantially reformed within the last thirty years. Similarly the directors duties, the modes of enforcing corporate rights, and the shareholders remedies were exhaustively overhauled. These reforms were heavily and predominantly influenced by the American corporate law principles, more particularly in the area of the minority shareholder's derivative rights.

Thus this thesis analysed the statutory derivative action provisions in Alberta and Nigeria against the background of similar provisions in the United States of America. Among other things, it examined the origin and background of the present statutory derivative provisions in the three jurisdictions, assessed their present impact in achieving justice and fairness within the corporate entity, corporate democracy and equality. Further, it evaluated the shareholders control of the directors powers and compared the derivative action viz-a-viz other minority shareholder's actions. In the end the author offered suggestions for future reforms.

DEDICATION

Dedicated to ***Miss Olamide Monisola Obayemi*** *whom I am not privileged to see or touch today, but who is my only source of joy today, AND To my sister* ***Miss Olayinka Olutoyin Obayemi****, and my brother Mr* ***Ayodele Babajide Obayemi*** *who managed and endured with me during those trying months in Lagos from 1996 to 1998, AND To my mother* ***Mrs Caroline Ojuola Obayemi (nee Arogundade)*** *whom the Lord used to rescue me from the chilling abyss of darkness in 1985,AND To my late father* ***Pa Theophilus Olusegun Odunayo Obayemi****, who left this world before reaping the fruits of his labour, AND To my brother* ***Mr Olalekan Olatunde Obayemi****, who came back at the right time,*

AND

To ***Omotayo Onikolu, Folasade Ojumu, Helen Akingbade, Andrene Latoya James, Agnes Wafula, Katrina Haymond, Michelle MacKay, Olabode Ibironke, Olawale Sulaiman, Bankole Alade, Ibidapo Oyebolu, Idris Olayinka, Kayode and Grace Oyedotun, Dipo Omotoso, Bunmi Faleye, Nataliya Vladimirovna Olifirenko, Navy Captain & Mrs Enoch Oluwatade Ogunfiade, Mr & Mrs Richard Onikepe Adebayo, Mr Jacob Akintunde Obanishola (Late), Babatunde Omotoba, Adeniyi Elumaro, Wole Olaniran,Madam Wuraola Arogundade (Mama Alagbafo), Boniface Ahunwan, Wade Clark, Ven. Kathy Bowman, Denzil Small, Peter & Barbara Monk, Henry Ntale, Kumarie Achabair-Morrison, Babatunde Awodiran, Brian & Nancy Penny, Ademola Kuye, Olorunfemi Toyo, Frederick Adebayo, Alhaja, Ivor Edwards, Glenn Stewart, Ehi Oserogho, Ademola Odeyemi, Lekan Odewole, Meiti Yang, Yemi Adewunmi, and all others.***

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INTRODUCTION

I. Theme

The statutory derivative action permits a shareholder to come to court and enforce a right vested in the corporation or to obtain a remedy against the company's directors, officers and controlling shareholders for a breach of their fiduciary and legal duties owed both to the corporation and the minority shareholders.[1] It developed mainly from the underlying common law principle that the directors owe their duties to the corporation alone and not to any shareholder.[2] This in turn was derived from partnership law.

Over the years, it has been recognized that the proper person to sue for a wrong is the victim, *ipso facto,* the proper plaintiff to ask for a relief based on a corporate wrong should be the corporation itself. This larger than life rule known as "the proper plaintiff principle," simply requires that where a wrong has been done to a corporation, only the corporation and not the individual shareholders can take action to remedy the wrong. The second principle known as the "internal management rule" states that the will of the majority of the members of the corporation should generally prevail in the running of its business, and in effect if the majority does not want to take action on the alleged corporate wrong or breach of duty, then the issue is foreclosed, and where the wrong is ratifiable or capable of being regularized by the majority in accordance with the corporate constitution, the minority is precluded from

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[1] See generally E. Oladeji Akanki, "Corporate Litigation" (1987) 3 & 4 Obafemi Awolowo Uni. L. J. 41; Lynn R. Campbell, "Summary Enforcement of Directors' Duties: *Re Goldhar and Quebec Manitou Mines Ltd.*" (1977-78) 2 Can. Bus. L. J. 92; Stanley M. Beck, "An Analysis of *Foss v Harbottle*" in J. S. Ziegel, ed., *Studies in Canadian Law,* Vol. 1 (Toronto: Butterworths, 1967) at 545.

[2] *Percival v. Wright,* [1902] 2 Ch. 421 (Ch. D.).

suing on it. The above two related principles combine to form "the rule in *Foss v. Harbottle.*"[3]

The rights and duties of the various organs and groups within the corporate setup have been discussed by legal scholars and commentators over the years. The success of the corporation and the different players within it depends, to a large extent, on the ability of the different players within it to manage the company's affairs, observe their individual respective duties and, at the same time, realize their goals. Consequently, the legitimate expectations of a person who purchases shares in a company should be safeguarded and met by all means in that within the corporation there are various persons whose legitimate corporate expectations are not necessarily merged with that of the corporation's. Thus these shareholders' expectations should be safeguarded from the whims and caprices of the directors and majority.[4] The statutory derivative action, as well as other minority shareholders remedies, have as their central focus the protection of the reasonable and legitimate expectations of the minority shareholder. Consequently, the theme of this research work is centered around a comparative analysis and evaluation of the minority shareholder's statutory derivative rights in Nigeria, Canada and the United States of America.

II. Structure

Within the last twenty-five years, most commonwealth countries have taken bold steps towards the protection of the minority shareholder's rights and interests within the corporation with the enactment of various statutory derivative action provisions which are

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[3] (1843), 2 Hare 461; 67 E.R. 189 (Ch. D.); See also s. 299,*Companies and Allied Matters Act*, Cap 59, Laws of the Federation of Nigeria, 1990.

[4] See *Ebrahimi v. Westbourne Galleries Ltd.*, [1972] 2 All E.R. 492 (H.L.).

very similar to the American derivative procedural devices representing a complete break from the old restrictive English common law rules.

This research paper will thus undertake an analysis of the statutory derivative actions provisions under the Nigeria *Companies and Allied Matters Act* [5] and the Alberta *Business Corporations Act*[6] (which contains provisions substantially identical to most Canadian jurisdictions) against the background of American business corporation law principles on derivative actions. The research will seek to determine how far the courts in Nigeria, Canada and America have been able to implement these laws as well as achieve the aims and spirit behind these corporation statutes.

Chapter One looks at the historical background of the statutory derivative provisions by considering the corporation's separate personality principle laid down in *Salomon v. Salomon & Co. Ltd.*,[7] the old common law rule in *Foss v. Harbottle* and its two related principles-the proper plaintiff rule and the internal management rule. It examines the rationale behind the rule in *Foss v. Harbottle,*and the various fiduciary and legal duties of honesty, good faith and acting with due care, skill and diligence in the corporation's best interests imposed on the directors and the controlling shareholders in order to regulate the use of the broad managerial powers conferred on them under the law.

Chapter Two looks at the concept of "minority shareholder," the recognition of the need to balance intra-corporate democracy against the board's integrity in the exercise of their

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[5] Cap 59, Laws of the Federation of Nigeria, 1990.

[6] S.A. 1981, c B-15.

[7] [1897] A. C. 22.

corporate powers, the recognized traditional common law exceptions to the rule in *Foss v. Harbottle,* the background to the American derivative action provisions in equity, and the recommendations of the various Law Reform Commissions in Canada and Nigeria within the last three decades.

Chapter Three considers in detail, the various procedural steps under the Canadian and Nigerian corporation statutes for instituting statutory derivative actions against the background of similar provisions under the American business corporations laws.The discussion covers a number of topical issues such as the "double" and "triple" derivative suits, the notice or demand requirement, good faith, the corporation's best interests requirement, the residual "proper person" category, the standing of past owners of the corporation's securities to qualify as complainants, and the creditors position to qualify as complainants. It will also consider in detail the American "contemporaneous ownership rule" and the "futility exception" to the requirement of service of notice on the board.

Chapter Four examines the situations and circumstances when a court, either on substantive or procedural grounds, may refuse a shareholder standing to prosecute a derivative action despite the shareholder having met all the statutory requirements. In particular, the role, scope and powers of the board's Special Independent Litigation Committee, the court's evaluation of the committee's pretrial motion to dismiss the derivative action as not being in the corporation's best interests, and the board's business judgement rule under the America business law will be considered to see their relevance and applicability in Nigeria and Canada.

Chapter Five evaluates the various regulatory and discretionary powers of the court

conferred by the corporation statutes for the regulation of the derivative proceedings. It looks at topical issues such as security deposit, the court's discretionary powers to award legal cost against the company, allowing settlement or discontinuance, and in making personal awards.

In chapter Six, the shareholder's derivative action is compared viz a viz other minority shareholder's actions such as personal and class/representative actions and the relief based on grounds of oppression and unfairness.

III. Context

The research will focus mainly on the Nigerian, Canadian (with Alberta as the focal point), and American business environment and corporation laws. The Nigerian companies law is not as developed or tested as its North American counterparts, and the aim of this research is to assist in the reform of the Nigerian law in light of the developments in Canada and America.

IV. Terminology

This author uses various terminologies that are similar in meaning in Nigeria, Canada and America. While it is appreciated that some of these terms are used very commonly in some jurisdictions more than others, the equivalent terms carry similar meanings in the remaining jurisdictions. The following terms are used interchangeably in the paper:

a. Derivative actions/Derivative suits.

b. Companies/Corporations.

c. Corporations Act/Companies Act.

d. Corporations law/Companies law.

e. Corporate law/Company law.

f. Applicant/Complainant.

g. Notice/Demand.

h. Managers/Officers.

i. Actions/Suits.

V. Appendixes

Attached to this paper is a reproduction of the relevant provisions of the Alberta *Business Corporations Act,*[8] 1981, and the Nigerian *Companies and Allied Matters Act,*[9] 1990, regulating the shareholder's derivative rights.

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[8] *Supra* note 5.

[9] *Supra* note 4.

CHAPTER 1

THE HISTORICAL BACKGROUND

The statutory derivative remedy authorizes shareholders and other corporate stakeholders, in certain circumstances, to bring an action on behalf of the corporation to enforce rights or remedies belonging to the corporation. Derivative actions represent an exception to the generally applicable legal principle that suits should be brought only by the entity directly sustaining the loss. Because of the separate existence of the corporation itself from its shareholders and other stakeholders, the corporation itself would ordinarily be expected to bring an action to redress a wrong or to recover a lost opportunity or benefit to which it is entitled. However, where the wrongdoing giving rise to a cause of action involves mismanagement of the corporation in some way or other, the corporation may not be motivated to seek redress for the wrongdoing.

The statutory derivative action is recognized as serving a dual purpose. First, it ensures that shareholders can recover property belonging to the corporation or enforce rights to which the corporation is entitled where management or the directors refuse to take action. Through the derivative action corporate stakeholders, on behalf of the corporation, may sue the wrongdoer in the name of the corporation or defend the corporation from a claim that the directors refuse to defend. A second major objective of the statutory derivative remedy is the promotion of managerial responsibility and accountability. Derivative actions provide a mechanism whereby shareholders can ensure that management (including boards of directors) is doing its job. Because it is to the corporation, and not to its owners or other stakeholders, that management and boards of directors owe their responsibilities, the derivative action is necessary if the owners of the corporation and other stakeholders are to protect the interests of the corporation against insider wrongdoing. The statutory derivative action provides stakeholders with recourse if the directors or officers damage the corporation by misusing assets or taking personal advantage of corporate opportunities.[1]

I. Introduction

The derivative action is a twofold action in nature: it is the equivalent of a suit by shareholders to compel the corporation to sue and it is also a suit by the corporation, asserted by the stockholders on its behalf against those liable to it.[2] According to Professor Robert Clark:

> The common law countries have devised one of the most interesting and ingenious of accountability mechanisms for large formal organizations: the shareholder's derivative suit. In

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[1] MacCarthy Tetrault, *Directors' and Officers' Duties and Liabilities in Canada* (Toronto: Butterworths, 1997) at 70-71; See also E. Oladeji Akanki, "Protection of the Minority in Companies" in E. O. Akanki, ed., *Essays on Company Law* (Lagos: University of Lagos Press, 1992) 276.

[2] Edward P. Welch & Andrew J. Turezyn, eds., *Folk on the Delaware General Corporation Law: Fundamentals,* 1998 ed., (New York: Aspen Law & Business, 1998) at 815.

> such a suit, the shareholder sues on behalf of the corporation for harm done to it. Ordinarily, therefore, any damages recovered in the suit are paid to the corporation. Historically, the derivative suit was conceived of as a double suit, or two suits in one: The plaintiff (1) brought a suit in equity against the corporation seeking an order compelling it (2) to bring a suit for damages or other relief against some third person who had caused legal injury to the corporation. Although not inevitably, the third person was usually an officer, director, or other fiduciary of the corporation. Although each derivative suit is now very definitely treated in the courts as a single case, the historical conception survives in the customs of making the corporation a nominal defendant in the action and allowing it to raise various objections to the suit.[3]

To John Martel and Charles Sink,[4] a minority shareholder's derivative action is "a suit in equity by a shareholder to enforce a corporate right or claim." The subject of derivative actions of the minority shareholder and the enforcement of the corporate rights have been of great concern to most legal systems in the last 125 years. In Canada, the 1970s witnessed major reforms in the field of business corporations laws to the effect that there was a relaxation of the rigid application of the common law principle of majority rule to favouring a strong emphasis on the application of the American business corporations law principles on shareholders remedies and the equitable principles of fairness, corporate equality and justice towards the protection of the minority within the corporate structure.[5] The 1970 reforms were meant to provide exhaustive statutory provisions specifying clear procedural steps aimed at easing the right and access of a minority shareholder to come to court to enforce corporate

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[3] Robert Charles Clark, *Corporate Law* (Boston: Little, Brown & Co., 1986) at 639-640.

[4] John S. Martel & Charles M. Sink, "The Derivative Action: Is There Life After Lasker?" in J.S. Martel, ed., *The Investor and the Corporation New Developments and Tactics in Stockholder Litigation* (New York: Practising Law Institute, 1980) at 201; In *Omisade v. Akande* (1987), 2 N.W.L.R. 158. (Nig. S.C.), the Nigerian Supreme Court per Mohammed Bello, C.J.N. at 168, held that "a minority shareholder's action or derivative action is a procedural device by means of which on the principle of equity a relief, such as restitution of unjust enrichment by its director, is sought on behalf of a company."

[5] Phillip Anisman,"Majority-Minority Relations in Canadian Corporation Law: An Overview" (1986-87) 12 Can. Bus. L. J. 473.

rights and breaches of the directors duties.[6]

The aim of this thesis is to analytically consider the statutory provisions of the Canadian and Nigerian corporation laws against the background of similar corporate law rules in various American jurisdictions as of today, and see how far they guarantee the minority shareholder's access to courts for redress. The protection of the minority shareholder's right by way of statutory derivative actions is one of the major themes of the statutory corporation laws of both jurisdictions.[7] The underlying rationale of the derivative action provisions is to abrogate the old common law rule restricting the minority shareholder's access to the court which favored the majority more often than the minority and which shielded most intra-corporate injustices from judicial redress. Thus a clear understanding of the reviewed rights of the minority shareholder will involve a brief explanation of the salient theories of modern corporation laws in Nigeria, Canada and America. Consequently, this chapter will start with an analysis of the old English rule regarding actions for rectifying corporate injuries which represents the launching pad for the present state of developments in modern corporation law.

Modern corporation law is predicated principally on four basic principles around which company law jurisprudence rotates and which dominate the discussion of business corporations laws.[8] Thus any work on shareholders remedies would be incomplete without

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[6] Gordon Phillips, *Personal Remedies for Corporate Injuries,* (Scarborough: Carswell, 1992) at 347.

[7] See generally the Nigerian *Companies and Allied Matters Act,* Cap 59, Laws of the Federation of Nigeria (1990) at s. 303; the *Business Corporations Act*, S.A., 1981 c B-15 at s. 239; D. H. Peterson, *Shareholder Remedies in Canada* (Toronto: Butterworths, 1989).

[8] Bruce Welling, *Corporate Law in Canada:The Governing Principles,* 2nd ed., (Toronto: Butterworths,1991) at 53; J. Olakunle Orojo, *Company and Practice in Nigeria,* 3rd ed., (Lagos: Mbeyi and Associates,1992) at 16-28.

a brief consideration of these fundamental principles. First, there is the principle of separate corporate personality which stipulates that as from the date of incorporation, a company has a separate and distinct personality different from the members constituting it, with rights and duties analogous to those of a human being.[9] This principle has been incorporated indirectly into Section 37 of the Nigerian *Companies and Allied Matters Act* (hereinafter "the CAMA"),[10] and Section 9 of the Alberta *Business Corporations Act* (hereinfater "the ABCA"). [11] Furthermore, sections 38(1) and 15(1) of the CAMA and ABCA respectively

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[9] *Salomon v. Salomon & Co. Ltd.*, [1897] A.C. 22 (H. L.); *Lee v. Lee's Farming Ltd.*, [1961] A.C. 12 ; *Macaura v. Northern Assurance Co.*, [1925] A.C. 619; *Banque De L'Afrique Occidentale v. Habu* (1964), N.N.L.R. 30 (Nig. S.C.); Bruce Welling, *supra* note 8 at 100-104; *Constitution Insurance Co. of Canada v. Kosmopolous* (1987), 1 S.C.R. 1. In the United States of America for instance, there are various ways by which the shareholders or members of a joint venture could shield themselves from corporate liability. First they could form a partnership in which case they have two options open, i.e. General Partnership or Limited Partnership. While a general partnership does not afford either immunity from business debts/liabilities or tax losses, a limited partnership provides immunity from business liabilities for the limited partner who does not participate in the running of the partnership affairs. Further in Vermont for example, under Vermont *Business Corporation Act,* Vt. Stat. Ann. Tit. 11A, once the articles of incorporation containing specific information are filed with the Secretary of State, and the corporation adopted bylaws and elected a board of directors, then a corporation comes into existence. The corporation could elect to have an "S" status, which would allow a pass through income tax treatment, however there are some limitations, such as that the shareholders can not exceed 75 and none may be a foreign citizen. The shareholders may also elect a "C corporation" status, which would allow for control by them, liability protection, and the opportunity to bring in an additional shareholder at a later date. They could also adopt a "Limited Liability Company" (LLC) status in which case they will have a corporate style liability protection and lots of tax flexibility. The LLC may be member-managed or manager-managed depending on the Articles of Organization and the requisite written Operating Agreement, and unlike a Limited Partnership, all members may participate in the operation of the business without losing their limited liability protection. There is also provision for the formation of a "Close Corporation." A close corporation may be set up like any other company, but its articles of incorporation must contain certain additional requirements and restrictions. Here certain formalities are relaxed, as it is not required to have a board of directors and may not have annual meetings. It is also possible to regulate the exercise of powers and management of business and affairs of the corporation or the relationship between the shareholders by the "shareholders agreement," and to create a relationship among shareholders or between the shareholders and the corporation that is appropriate among partners, however it would be possible to pass tax losses to the individuals by making an "S" status election.

[10] Cap 59, Laws of the Federation of Nigeria 1990; see also *Gresham Life Assurance v. Registrar of Companies* (1973), 1 All N.L.R. 617 (Nig. S.C.).

[11] *The Business Corporations Act,* S.A.1981 c B-15. In *C.P.W. Valve And Instruments Ltd.v. Scott* (1978), 84 D.L.R. (3d) 673 (Alta. C.A.) the issue as to the date which the corporation comes into existence came up in the court for consideration. However the controversy generated as to whether the corporation was indeed registered

provide that a corporation has the privileges, rights, powers and capacity of a natural person in the performance of its business. In a related fashion, sections 21 and 43 of the CAMA and ABCA respectively also provide that shareholders as shareholders are not liable for any liability, debt or default of the corporation after the amounts unpaid on their shares. The combined effect of these provisions is that the process of incorporating a company involves the severance of all legal connections between the shareholders on the one part, and the assets and liabilities of the corporation on the other, and if the business fails and debts remain unpaid, the creditors cannot look to the shareholders for recovery.[12] In this connection, Harry Sutherland noted that:

> A corporation is regarded at law as a persona or entity distinct from the shareholders who compose it. It is not like a partnership, a mere collection or aggregation of individual units. This distinction between the corporation as a body corporate and its shareholders is fundamental.[13]

Second, there is the principle of organic division of powers within the corporation, which is the recognition that powers of management and internal corporate decisions are to be exercised by an independent managerial group otherwise known as the board of directors[14]

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on a different date from the one shown on the certificate appears to have been laid to rest by section 9(2) of the ABCA. Thus in *Prim Investments Ltd. v .Madison Development Corporation and Proskiw,* [1982] 20 B.L.R.108 (Alta. Q.B.), the court held that the corporation is for all purposes formed on the date shown on the certificate of incorporation. Similarly section 106 of the Delaware *General Corporation Law,* Del. Code Ann.tit. 8 (Supp. 1993) provides that the corporate existence begins as of the filing date of the certificate of incorporation, unlike the old law where the corporation comes into being only after the certificate has been filed and recorded and taxes and fees had been paid.

[12] The effect of incorporation is basically that each shareholder recieves shares or stocks in exchange for his investment in the company, and such investment may take the form of property transferred to the company which then becomes the assets of the corporation, and any profits or debts arising from the use of the investment remains that of the corporation alone. See also *Macaura v. Northern Assurance Company Ltd.,* [1925] A.C. 619 per Lord Buckmaster at 623.

[13] Harry Sutherland, et.al., *Company Law of Canada,* 6th ed., (Scarborough: Carswell, 1993) at 17.

[14] *Automatic Self-Cleansing Filter Syndicate Co. v. Cuninghame,* [1906] 2 Ch. 34 (C. A.); *Lennard's Carrying Co. Ltd. v. Asiatic Petroleum Co. Ltd.,* [1915] A.C. 705; See CAMA s. 63(3); see also ABCA s. 97.

who may delegate the power of day-to-day running of the company to a professional group called officers i.e. "the managers." This is the main difference between a corporation and a sole proprietorship:

> It is possible for the shareholders of a company in general meeting to be granted extensive authority in connection with the management of the business of the company. However, the actual practice is to entrust the board of directors with the exclusive power to manage the company and to grant that power free from interference from the shareholders.[15]

In connection to the board of directos' broad managerial powers are the powers to issue shares and control the use of the corporate name in litigation.[16]

Third, there is the principle of majority rule which recognizes that decisions within the corporation are to be reached through a democratic process whereby those allowed to vote, under the corporate constitution, on the corporate issues being considered are given the opportunity to do so.[17]

Lastly there is the principle of minority protection which recognizes that if the legitimate expectations and aspirations of all corporate players are to be met, then it is necessary to restrain some managerial or majority excesses and afford some protection to the minority.[18]

The principle recognizing the corporation's separate and distinct personality is the most relevant of the above principles in analyzing the origin of minority protection laws in

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[15] The Continuing Legal Education Society of British Columbia, *Company Law,* (Materials Prepared for a Continuing Legal Education Seminar Held in Vancouver, B. C. on November 26 & 27, 1987) at 4.1.01.

[16] *Ibid.*

[17] See CAMA ss 224-232 and 263-266; ABCA ss 102 and 132-136.

[18] See CAMA ss 299-330 (Part X); ABCA ss 231-245 (Part 19); Bruce Welling, *supra* note 8 at 516.

modern corporation laws. A lucid and complete comparative analysis of the Nigerian and Alberta (whose corporation law contains identical provisions with certain other Canadian jurisdictions) corporation laws must begin with that.

II. The Principle of the Corporation's Distinct and Separate Personality

As a business convenience the concept of artificial personality has been bestowed on the corporation by law and it recognizes the distinction between the business association and its members.[19] The corporation is created and recognized by law as being subject to rights and duties different and separate from its members. This has been hailed as the greatest accomplishment of company law, and its relevance in understanding every aspect of corporation law is without doubt and so Professor Oladeji Akanki of University of Lagos had observed that:

> ....functionally, it is a cornerstone of company law. Quite clearly corporate personality is the most pervading of the fundamental principles of company law in that many legal barriers against abuses derive their basis and juristic force from it.[20]

At common law, in 1897, the English House of Lords in *Salomon v. Salomon & Co.Ltd.*,[21] judicially recognized the corporate personality rule for the first time, and according to Lord MacNaghten:

> I cannot understand how a body corporate made capable by the statute can lose its individuality by issuing the bulk of its capital to one person...The company is at law a different person

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[19] See A. W. Machen, Jnr., "Corporate Personality" (1910-11) Harv. L. Rev. 253; see also ABCA s. 43 on shareholders' immunity from corporate debts and liabilities.

[20] E. Oladeji Akanki,"The Relevance of Corporate Personality Principle" (1977-80) 11 Nig. L. J. 9.

[21] [1897] A.C. 22 (H. L.); there have been similar cases decided on the same principle e.g. *Rainham Chemical Works Ltd. v. Belevedere Fish Guano Co.*, [1921] 2 A.C. 465 at 475-501 (H.L.); *Meadow Farm Ltd. v. Imperial Bank of Canada,* [1922] 66 D.L.R. 743 (Alta. C.A.); *Clarkson Co. v. Zhelka,* [1967] 2 O.R. 565 (Ont. H.C.); *White v. Bank of Toronto,* [1953] O.R. 479 (Ont. C.A.).

altogether from the subscribers to the memorandum.[22]

Application of this principle makes it very easy and less intractable in apportioning rights, duties, and liabilities among the different corporate players, and in solving basic legal issues relating to the company's activities such as its legal competence and the scope of its capacities including those persons constituting it.[23] It is the recognition of a corporation as a separate person at law that forms the basis of the rule that where a wrong is done to the corporation or where a person has breached a duty owed to it then only the corporation itself, and no other person, has the right to sue at law.

III. The Division of Powers within the Corporation and the Board's Powers of Management and Control over Corporate Litigation

The corporation is composed of the shareholders, directors, officers and employees, and, as an artificial person, it must have organs to enable it to function. Thus Viscount Haldane stated:

> My Lords, a corporation is an abstraction. It has no mind of its own any more than it has a body of its own; its active and directing will must consequently be sought in the person of somebody who for some purposes may be called an agent, but who is really the directing mind and will of the corporation, the very ego and the centre of the personality of the corporation. That person may be under the direction of the shareholders in general meeting; that person may be the board of directors itself....[24]

The major organs of a corporation are thus the shareholders in a general meeting, the

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[22] *Salomon v. Salomon & Co. Ltd.*, [1897] A.C. 22 at 51(H.L.).

[23] See E. Oladeji Akanki, *supra* note 20 at 14.

[24] Viscount Haldane, L.C. in *Lennard's Carrying Co. v. Asiatic Petroleum Co.*, [1915] A.C. 705 (H.L.) at 713.

board of directors, and the duly appointed officers.[25] At common law, before 1906, it was thought that the general meeting could override the decisions of the board with regard to the management of the corporation,[26] but in *Automatic Self-Cleansing Filter Syndicate Co.v. Cuninghame,*[27] the board's undisputed absolute managerial power (which includes the power to institute legal proceedings on behalf of the company) was recognized by the court. Thus under the contractarian system,[28] the managerial powers are originally vested on the shareholders who subsequently delegate such powers to the board of directors.[29] Once the managerial powers have been delegated on the board, they cannot be removed by the shareholders except via a special resolution amending the constating documents.[30] For example section 141(1) of the *British Columbia Companies Act*[31] (hereinafter "the BCCA") provides that:

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[25] See also CAMA s. 65. The ABCA in section 97(1) preserves the directors managerial powers, in section 110 allows the board to appoint a Managing Director, and in section 140 gives the shareholders powers to take a Unanimous Shareholders Action divesting the directors of their managerial powers. In *Freeman & Lockyer (A Firm) v. Buckhurst Park Properties (Mangal) Ltd.,*[1964] 1 All E.R. 630 (C.A.), the English Court of Appeal recognized the Managing Director's apparent and usual authority to take many important business decisions on behalf of the corporation, while in *Canadian Jorex Ltd v. 477749 Alberta Ltd.*(1991), 85 Alta L.R. (2d) 313 (C.A.) the board's wide managerial powers was recognized in the Canadian Division of Powers jurisdictions.

[26] *Isle of Wight Railway v. Tahourdin* (1884), 25 Ch.D. 320 (C.A.).

[27] [1906] 2 Ch. 34 (C.A.).

[28] Otherwise called the memorandum jurisdiction model which is the model for England and almost all jurisdictions having English company law as their source of corporation laws, and here the memorandum and articles of association are a statutory contract between the company, its shareholders and directors and enforceable against each of the classes of persons; See also *Quinn & Axtens Ltd. v. Salmon,* [1909] 1 Ch. 311 (C.A.).

[29] See for example section 55 of Table A in the First Schedule to the *Alberta Companies Act.*

[30] See B. Welling, W. B. Rayner, C. Jordan & L. D. Smith, eds., *Canadian Corporate Law: Cases, Notes & Materials,* (Toronto: Butterworths, 1996) at 190-191.

[31] R.S.B.C. 1979, c. 59.

> The directors shall, subject to this Act and the articles of the company manage or supervise the management of the affairs and business of the company.[32]

Section 63(3) of the CAMA similarly provides:

> Except as otherwise provided in the company's articles, the business of the company shall be managed by the board of directors who may exercise all such powers as are not by this decree or the articles required to be exercised by the members in general meeting.

Much like the above contractarian models, the ABCA, a "division of powers" model[33] in section 97(1) provides:

> Subject to any unanimous shareholder agreement, the directors shall manage the business and affairs of a corporation.[34]

In this connection, section 141(a) of the Delaware *General Corporation Law*[35] also provides that:

> The business affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors.....[36]

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[32] The standard form of articles of companies registered in British Columbia under the BCCA usually contain similar provision. For a detailed study of the Nigerian companies directors duties, see E. O. Akanki, "Company Directors' Responsibility" A Paper Presented at a Seminar Titled *The Role of Company Secretary in Corporate Management,* at the Federal Palace Hotel, Lagos, Nigeria on October 25, 1994. (Unpublished).

[33] Under the division of powers model, the corporation statute imposes a division of powers on the participants, the shareholders, directors and officers in a corporation, and each participant is assigned certain powers and obligations. These powers and obligations are clarified, sometimes modified and only rarely removed by the constating documents. These managerial power conferred on the board includes to a large extent the power of control over corporate litigation. See B. Larson, "Control of Corporate Litigation in the Light of the Doctrines of Constitutional Contract and *Bamford v. Bamford*" (1970) 5 U. B. C. L. Rev. 363.

[34] For a detailed consideration of the directors powers under the ABCA, see R. W. Ewasiuk, "Certain Aspects of Directors' Powers and Obligations Under the Business Corporations Act" (1984) 22 Alta. L. Rev. 541. The same provision is in *Canada Business Corporations Act,* ("the CBCA"), R.S.C. 1985, c. C-44.

[35] Del. Code Ann. tit. 8 (Supp. 1993); see also New York *Business Corporation Law,* s. 626 (McKinney 1996).

[36] A fundamental precept of Delaware corporation law is that it is the board of directors, and not shareholders nor managers, that has ultimate responsibility for management of the enterprise. See *Grimes v. Donald,* 673 A.2d 1207 (Del. S.C. 1996).

From the above, it is clear that modern statutes expressly confer the powers of management on the board, who usually delegate the duties of day-to-day running of the company's affairs to the officers and other corporate employees to act on the corporation's behalf. These managerial powers have been held to include power to commence legal actions on behalf of the company, and so Mr Jusitce Louis Brandeis noted:

> Whether or not a corporation shall seek to enforce in the courts a cause of action for damages is, like other business questions, ordinarily a matter of internal management, and is left to the discretion of the directors, in the absence of instruction by vote of the shareholders. Courts interfere seldom to control such discretion intra vires the corporation, except where the directors are guilty of misconduct equivalent to a breach of trust, or where they stand in a dual relation which prevents an unprejudiced exercise of judgement.[37]

Fraser, J.A. had noted in *Canadian Jorex Ltd. v. 477749 Alberta Ltd.*[38] that the effect of section 102 of the CBCA[39] is that the directors powers to manage a corporation's affairs a re unlimited except to the extent of their being circumscribed by the corporation's by-laws or the unanimous shareholder agreement. With the above in mind it is reasonably foreseeable that the directors broad managerial powers, if left unchecked, may be abused or manipulated by an unscrupulous board to the detriment of the corporate goals and interests of the minority shareholders. This can be very glaring where the persons who constitute and dominate the board are either the majority shareholders in the corporation or, at the same time, are the wrongdoers. Thus the various corporations legislation imposed wide duties on the directors to regulate and control the exercise of their powers of management.

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[37] *United Copper Securities Co. v. Amalgamated Copper Co.*, 244 U.S. 261 at 263-264 (1917).

[38] (1991), 117 A.R. 222 at 224 -225 (C.A.).

[39] Contained in section 97(1) of the ABCA.

IV. The Fiduciary/Good Faith and the Care, Skill & Diligence Duties Imposed on the Board and the Majority Shareholders in Exercising Corporate Powers of Management

The CAMA and ABCA both envisaged the dangers of leaving the directors at large with the broad powers of management and thus decided to impose fiduciary and legal duties on them.[40] The directors serve as fiduciaries owing a duty of care to the corporation[41] and in peculiar situations they are fiduciaries of the stockholders.[42] These duties have their foundations in equity, contract, trust[43] and torts and hence are known as the legal and fiduciary duties. The fiduciary duty requires that the directors act honestly, with utmost good faith and in the best interests of the corporation in all their dealings with the corporation. While the legal competence duty requires them to act with due care, skill and diligence as a reasonably prudent person would do in comparable circumstances. The courts will most readily find a director liable where there has been a derogation from his duty.

At common law these duties include the duty to act bona fide in the interest of the company which includes the duty that the directors act not for their own interests or those of

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[40] See CAMA ss 279-292; ABCA ss 114-117.

[41] *Mills Acquisition Co. v. MacMillian Inc.*, 559 A.2d (Del. S.C. 1988) 1261 at 1280; *Revlon Inc. v. MacAndrews & Forbes Holdings,* 506 A.2d (Del. S.C. 1986) 173 at 179.

[42] For example in *Tongue v. Vencap Equities Alta Ltd.* (1996), 6 W.W.R. 761 (C. A.); *aff'g* [1994] 5 W.W.R. 674 (Alta. Q.B.) it was held that directors will owe fiduciary duties to individual shareholders where the directors act outside their ordinary duties, or when the directors purchase shares from shareholders or where the facts necessitate the finding of such fiduciary duties.

[43] See Harold Marsh, "Are Directors Trustees? Conflict of Interest and Corporate Morality" (1966) 22 Business Lawyer 35.

the shareholders who elected them,[44] the duty to exercise corporate/management power for a proper purpose and not for a collateral purpose such as that aimed at diluting the shares of majority shareholders,[45] the duty to avoid conflict of personal interest with their duty to the corporation,[46] the duty not to fetter discretion,[47] the duty not to compete with the company,[48] the duty not to commit corporate waste or sell the corporate office to looters, the duty of care, skill and diligence,[49] and other minor fiduciary duties that evolved out of case law. The essence of these duties is to ensure that the directors use the enormous managerial powers at their disposal for the ultimate corporate good.

The CAMA is a hybrid of both the "contractarian" and the "division of powers" models in its attempt at codifying the directors duties as it contains provisions embodying all the above principles and at the same time goes further by reflecting the major North American

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[44] *Re Smith & Fawcett Ltd.*, [1942] Ch. 304 (C.A.); *Greenhalgh v. Arderne Cinemas Ltd.*, [1951] Ch. 286 (C.A.); *Scottish Cooperative Wholesales Society v. Meyer*, [1959] A.C.324 (H.L. Scot.); See also CAMA s. 279(3).

[45] See CAMA s. 279(5); *Punt v. Symons & Co Ltd.*, [1903] 2 Ch.506 (Ch. D.); *Piercy v. Mills & Co.*, [1920] 1 Ch.77 (Ch. D.); *Hogg v. Cramphorn Ltd.*, [1967] Ch. 254 (Ch. D.); *Howard Smith Ltd. v. Ampol Petroleum Ltd.*, [1974] A.C. 821; *Tikatore Press Ltd. v. Abina* (1973), 1 All N.L.R. (Pt II) 244 (Nig. S.C.).

[46] See CAMA s. 280 ; ABCA s. 115; *Aberdeen Railway v. Blaikie Brothers* (1843-60), All E.R. 249 (H.L. Scot.); *Lagunas Nitrate Co. v. Lagunas Syndicate*, [1899] 2 Ch 392 (Ch.D.); *Nasr v. Berini Beirut Bank* (1967), 2 A.L.R. Commercial 78 (Nig. S.C.); *Boston Deep Sea Fishing Co. v. Ansell* (1888), 39 Ch. D. 339; *Regal (Hastings) Ltd. v. Gulliver*, [1967] 2 A.C.134n (H.L.).

[47] See CAMA s. 279(6); *Thorby v. Goldberg* (1964),112 C.L.R.597 (Australia H.C.); *Cabra Estates Plc v. Fulham Football Club* (1994), BCLC 363 (C.A. Scot.).

[48] See CAMA s. 280(5) CAMA; *Peso Silver Mines Ltd. v. Cropper*, [1966] 58 D.L.R. (2d) 1 (B.C.S.C.); *Industrial Development Consultants Ltd. v. Cooley*,[1972] 2 All E.R. 162 (C. A.); *Boardman v. Phipps*, [1967] 2 A.C.46 (H.L.); *Canadian Aero Service Ltd. v. O'Malley (Canaero)*, [1974] 40 D.L.R.(3d) 371 (S.C.C.).

[49] See CAMA s. 282(1); ABCA s. 117(1) (b); *Re City Equitable Fire Insurance Co.Ltd.*, [1925]1 Ch. 407 (C.A.).

enlargement of the directors fiduciary and legal duties.[50] Under the ABCA, a division of powers model, the fiduciary and legal duties of the managers are clearly spelt out in section 117(1) which provides that:

> Every director and officer of a corporation in exercising his powers and discharging his duties shall
> (a) act honestly and in good faith with a view to the best interests of the corporation, and
> (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

a. The Fiduciary Duties

According to Robert Clark, "[d]irectors, officers, and in some situations, controlling shareholders owe their corporations, and sometimes other shareholders and investors, a fiduciary duty of loyalty (and good faith to act in the company's best interests at all times). This duty prohibits the fiduciaries from taking advantage of their beneficiaries (the company and the shareholders) by means of fraudulent or unfair transactions."[51] The good faith or

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[50] For example the principle recognizing that the directors and officers have fiduciary duties not to misuse corporate information and opportunity, even after resignation from the corporation, as laid down in *Canadian Aero Services Ltd. v. O'Malley (Canaero)*, [1974] 40 D.L.R. (3d) 371 (S.C.C.) is now expressly contained in section 280(5) of the CAMA as follows:

> The duty not to misuse corporate information shall not cease by a director or an officer having resigned from the company, and he shall still be accountable and can be restrained by an injunction from misusing the information recieved by virtue of his previous position.

[51] Robert Clark, *supra* note 3 at 141. See also A. A. Sommer, Jr., "The Duty of Loyalty in the ALI's Corporate Governance Project" (1983-84) 52 Geo Wash. L. Rev. 719.While this research will deal with the major directors/officers fiduciary duties, there are some minor fiduciary duties which have evolved from the American corporate jurisprudence. For instance, there is the duty of the directors and majority shareholders not to sell the corporation's stock to looters. A controlling shareholder (with either an actual majority or a working majority that he can effectively control the corporation) owes a duty not to sell his shares to a corporate looter---i.e. someone who will run the corporation into the ground for his own personal profit. In this regard controlling shareholders have a duty to investigate whether the prospective buyer is a looter especially where they have substantial cause to suspect so, where for example, the buyer offers an unreasonably attractive premium to the selling shareholder. Although receiving a premium for control shares is not improper per se, the fact that the selling shareholder is getting more than twice the Fair Market Value of his shares should raise his suspicion about the buyer's motives. Similarly, the American courts have held the directors and controlling majority liable for breach of their fiduciary duties where they have "sold the corporate office." The directors and

loyalty duty requires that the directors/managers act with fairness, truthfully and with loyalty in all their dealings with the corporation. Professor Robert Clark has identified four (4) basic paradigms encompassing situations in which the breach of fiduciary duties may be evident. We shall consider these categorizations and others:

i. Basic Self-Dealing[52]

ii. Executive Compensation[53]

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shareholders while selling their shares can not agree that such sale is conditioned on the resignation of the present directors along with the election of the buyer's preferred directors. Thus where the selling shareholder undertakes to ensure the replacement of all directors with the buyer's chosen directors and also receives an extra large premium, this will amount to a sale of the corporate office and a breach of fiduciary duties. For the Nigerian legal regime's treatment of the Directors' fiduciary duties, see Kiser D. Barnes, "Examination of Legal Concepts: Defining Directors' Fiduciary Duty" (1986) 2 Uni. of Ife L. Rev. 22.

[52] It can be noted that section 115(7) & (8) of the ABCA provides that a material contract between a corporation and a director shall not be void or voidable only by reason of such director having an interest in the contract if there is full disclosure and the contract is fair and reasonable to the corporation. Moreover, general contract law provides that agreements between fiduciaries and their principals are not per se invalid but are subject to special restrictions in addition to normal contract defenses like fraud, duress, mistake, and so forth. The principal may rescind contracts with their fiduciaries if the contract is unfair to the principal regarding the transaction. These special rules are justified because of the high degree of trust and confidence that principals repose in fiduciaries. For example the American Bar Association's *Model Rules of Professional Conduct* (1983) reflects this principle by providing that business agreements between lawyers and their clients are not per se invalid, but are subject to special requirements:

> (a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:
>
> (1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which can be reasonably understood by the client;
> (2) the client is given a reasonable opportunity to seek the advice of independent counsel in the transaction; and
> (3) the client consents in writing thereto.

[53] Though at common law a director does not have an inherent right to receive compensation, under section 120 of the ABCA, the board of directors may fix their remuneration subject to a disclosure of the aggregate to the shareholders. However such remuneration must be commensurate with the services renderred or the directors will be subject to either a derivative or oppressive action under sections 232 or 234 of the ABCA respectively. The position under the CAMA is different, section 267 of the CAMA provides that the directors remuneration shall be fixed from time to time by the shareholders in a General Meeting and shall be deemed to accrue from day to day.

iii. The Taking of Corporate[54] or Shareholders[55] Property or Opportunity

iv. Corporate Action with Mixed Motives[56]

v. Waste of Corporate Assets

i. Basic Self-Dealing

This implies a situation where the corporation is transacting business either with the one of its directors or officers or with an entity in which a director or officer has some personal or significant financial interest.[57] In this regard, Lord Cranworth, L. C. in *Aberdeen Railway Co. v. Blaikie Bros.,*[58] had earlier noted that:

> ...it is a rule of universal application that no one having (fiduciary) duties to discharge shall be allowed to enter into engagements in which he has or can have a personal interest conflicting or which possibly may conflict with the interests of those whom he is bound to protect. So strictly is this principle adhered to that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into.

Similarly it was held in *North-West Transportation Co. v. Beatty,*[59] that:

> On the other hand, a director of a company is precluded from dealing, on behalf of the company, with himself, and from entering into engagements in which he has a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound by fiduciary duty to protect; and this rule is as applicable to the case of one of several directors as to a managing

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[54] The directors are enjoined from taking the corporation's property both under the ABCA and CAMA. For instance in the *Canaero case*, the Canadian Supreme Court held that the test was that of fairness,i.e., is it fair that the directors take the corporation's property ? Section 280 of the CAMA expressly prohibits the directors from making secret profit from their duties.

[55] Similarly both the CAMA and ABCA recognize that insider trading is both an injury to the corporation and the shareholder. For example, section 125 of the ABCA provides that an insider director who makes an improper profit from trading with a confidential information is liable topersonally compensate the injured shareholder for the direct losses suffered. Similar provisions are in section 620 of the CAMA.

[56] See Robert Clark, *supra* note 3 at 142.

[57] MacCarthy Tetrault, *supra* note 1 at 60; see also Robert Clark, *supra* note 3 at 159-189.

[58] (1854), (1843-60) All E.R. 249 at 252 (H.L. Scot.).

[59] (1887), 12 App. Cas. 589 at 593 (P.C.).

or sole director.

The underlying rationale precluding self-dealing is the likelihood and concern that the interested director will not bargain in the corporation's best interest. There is always a chance that he will give his own personal interest a large deal in the transaction and so compromise the corporation's interest, and this is against the background of contractual rule that business contracts are supposed to be arm length bargains. The position of the law making such contracts generally invalid has undergone changes, and now the contract is only *prima facie* voidable. In effect, it remains a valid contract for all purposes unless it is revealed to be unfair in an action being brought to set it aside.[60] In this connection for example, section 144 of the Delaware *General Corporation Law* provides that:

> (a) No contract or transaction between a corporation and one of its directors or officers, or between a corporation and any other corporation, partnership, association, or other organization in which one or more of its directors or officers, are directors or officers, or have a financial interest, shall be void or voidable solely for this reason.....

The same provision is now contained in section 115(7) and (8) of the ABCA, and the self-dealing contract is now not void automatically. The contract is valid provided the director discloses his interest in the contract,[61] obtains approval from the board of directors in which he is precluded from participating or voting or obtains approval from the shareholders,[62] and

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[60] Harold Marsh, "Are Directors Trustees? Conflict of Interest and Corporate Morality" (1966) 22 Business Lawyer 35 at 39-40.

[61] *State ex rel. Hayes Oyster Co. v. Keypoint Oyster Co.*, 391 P.2d 979 (Wash. 1964); *Globe Woolen Co. v. Utica Gas & Electric Co.*, 121 N.E. 378 (N.Y. 1918).

[62] Ratification does not on its own shield the contract from scrutiny, under sections 305 and 235(1) of the CAMA and ABCA, the existence of such an approval is only of evidentiary value only and it is not determinative of the issue. Thus Professor Robert Clark, *supra* note 3 at 178-179 noted that: "In practice, the courts seem to have a great deal of latitude in deciding how much weight to give to shareholder ratification and what effect it will have on the outcome of a particular case.....the effect of ratification varies with the kind

the contract must be fair and reasonable to the corporation in its entirety. Clearly, shareholders' ratification will not be an effective bar to an action to set aside self-dealing contracts, as the court will look beyond the formality of ratification to see if the contract is fair and reasonable in substance. Thus Welch and Turezyn have submitted:

> In general, stockholder ratification operates as a complete defense to a claim that a transaction is claimed to involve waste of assets, fraud, or be ultra vires. However, in duty of loyalty cases, stockholder ratification does not extinguish a claim of breach of fiduciary duty. In such cases,....if there is a controlling stockholder involved in the transaction, the potential for process manipulation by the controlling stockholder justifies the need for exacting judicial scrutiny and procedural protection afforded by the entire fairness form of review.[63]

ii. Executive Compensation

Historically, corporate managers have no inherent right to remuneration for their services unless permitted by either the statutes, the constating documents[64] or permitted by shareholders approval.[65] Most modern corporation statutes now provide that directors may approve compensation for services performed for the corporation.[66] Even with the recognition of the powers to fix their own remuneration, the directors being fiduciaries to the corporation from whom they are taking compensation, have to conform with the "Reasonable Relationship

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of self-dealing under attack...whatever the legal effect of a proper shareholder ratification may be, ratification is clearly considered improper if the shareholders do not receive full and adequate disclosure of matters material to what they are voting on."

[63] Edward Welch & Andrew Turezyn, *supra* note 2 at 110.

[64] *Hutton v. West Cork Railway* (1883), 23 Ch.D. 654 at 672 (C.A.); *Birney v. Toronto Milk Co.* (1902), 5 O.L.R. 1 (Ont. C.A.); *Roray v. Howe Sound* (1915), 22 D.L R. 855 (B.C.C.A.).

[65] *Minister of Railways & Canals v. Quebec Southern Rly; Hodge & White's Claim* (1908),12 Ex. C. R. 11; *Public Trustee v. Toronto Humane Society* (1987), 60 O.R. (2d) 236 (Ont. H.C.).

[66] See sections 267 and 120 of the CAMA and ABCA respectively which allow directors to receive remuneration for the services performed for the corporation. While under the CAMA the rate of compensation is to be determined by the shareholders in a General Meeting, under the ABCA, the directors fix their own remuneration subject to disclosure requirements.

Test" in fixing their remuneration:

> A conventional statement of the chief judge-made limitation on executive compensation is that it must be based on services performed for the corporation and must be "reasonable" in amount. Put another way, the amount of compensation must bear a "reasonable relationship" to the value of the services performed for the corporation.[67]

In effect, the compensation and services performed must be commensurate with each other or the court will find a breach of fiduciary duties based on excessive remuneration.[68]

iii. Taking Corporate or Shareholders Property or Opportunity

Professor Robert Clark has defined a "corporate opportunity" as follows:

> Perhaps the oldest judicial test of a corporate opportunity, and one that is still widely used, is that a corporate opportunity is a business opportunity in which the corporation has an *interest* or *expectancy* or which is *essential* to the corporation.[69]

The appropriation of corporate or shareholders opportunity or property by a director is a breach of fiduciary obligation. While an actual and outright taking of corporate property is fraud, on the other hand the taking of a corporate opportunity which is a specie of corporate property is also frowned at by the courts. In the words of MacCarthy Tetrault:

> The fiduciary obligations owed by directors and officers to the corporation will limit their ability to take advantage of business opportunities that might be available in the absence of the fiduciary relationship. The "corporate opportunity doctrine" is the phrase commonly used to describe the principles that restrict the ability of a director or officer to take up such opportunities for personal benefit. The doctrine is a specialized application of the rule prohibiting fiduciaries from entering into engagements involving a conflict of their personal interest and their duty to the corporation. Under the rule, as in other cases involving a conflict of interest and duty, a director or officer in breach of fiduciary duty must account to the corporation for, or disgorge, any profit recieved as a result of appropriating a business

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[67] Robert Clark, *supra* note 3 at 192.

[68] *Glenmore Distilleries Co. v. Seideman,* 267 F.Supp. 915 (E.D.N.Y. 1967); *Beard v. Elster,* 16 A.2d 731 (Del. S.C. 1960); *Black v. Parker Manufacturing Co.,* 106 N.E.2d 544 (Mass. 1952); *Berman v. Meth,* 258 A.2d 521 (Pa. S.C. 1969).

[69] Robert Clark, *supra* note 3 at 225.

opportunity properly belonging to the corporation.[70]

Traditionally, there were three main basic tests for identifying a corporate opportunity, i.e. the company must have either an "actual existing interest," or an "expectancy interest," or the business opportunity must be "essential" to the company. The rule forbidding the appropriation of corporate opportunities is very strict and the fact that the corporation can not avail itself of the opportunity will not be an excuse for the fiduciary to take it.[71] In *Lagarde v. Anniston Lime & Stone Co.,*[72] the court noted that directors must turn over to the corporation purchases from third parties when it is "property wherein the corporation has an *interest already existing* or in which it has an *expectancy growing out of an existing right*...where the officers' interference will in some degree balk the corporation in effecting the purposes of its creation."[73]

More recently, in deciding whether the directors have appropriated a corporate opportunity, the courts have evolved two additional yardsticks. In addition to the *existing interest, expectancy interest,* and *essential interest* tests identified above, there are now the *line of business*[74] and the *fairness* tests.[75] Thus the Delaware Supreme Court held in *Guth v.*

[70] MacCarthy Tetrault, *supra* note 1 at 49.

[71] *Regal (Hastings) Ltd. v. Gulliver,* [1942] 1 All E.R. 378 (H.L.); *Keech v. Sandford* (1726), Se. Cas. Ch. 61. (Ch.); *Cook v. Deeks,* [1916] 1. A.C. 554 (Ont. P.C.); *Peso Silver Mines Ltd. (N. P. L.) v. Cropper,* [1966] 58 D.L.R. (2d) 1 (S.C.C.); *Industrial Development Consultants Ltd. v. Cooley,* [1972] 1 W.L.R. 443 (C. A.).

[72] 28 So. 199 (Ala. S.C. 1900).

[73] *Ibid.* at 201.

[74] *Guth v. Loft Inc.,* 5 A.2d 503 (Del. S.C. 1939).

[75] *Canadian Aero Services Ltd. v. O'Malley,* [1973] 40 D.L.R. (3d) 371 (S.C.C.).

Loft Inc.,[76] that corporate opportunities will encompass any business opportunities that are within the subject corporation's "line of business":

> [W]here a corporation is engaged in a certain business, and an opportunity is presented to it embracing an activity as to which it has fundamental knowledge, practical experience and ability to pursue, which, logically and naturally, is adaptable to its business having regard for its financial position, and is one that is consonant with its reasonable needs and aspirations for expansion, it may be properly said that the opportunity is in the line of the corporation's business.[77]

In the *Canaero case,*[78] the Supreme Court of Canada adopted a loose-ended *fairness test* for determining whether there is an appropriation of a corporate opportunity which includes an examination of the position or office held by the fiduciary, the nature of the corporate opportunity, the amount, circumstances and nature of knowledge possessed, and the time the fiduciary relationship commenced amongst others.This is similar to the view of the Massachusetts Supreme Judicial Court in *Durfee v. Durfee & Canning Inc.*,[79] that the true basis of the corporate opportunity doctrine was the unfairness, on the particular facts, of a fiduciary taking an opportunity when the corporation's interests call for protection, and that the courts ought to apply ethical standards of what is fair and equitable to particular sets of facts. Furthermore, the Minnesota Supreme Court adopted a hybrid of the "line of business" and the "fairness" tests in *Miller v. Miller.*[80] Analysing this decision, Professor Robert Clark state that:

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[76] 5 A.2d 503 (Del. S.C. 1939).

[77] *Guth v. Loft Inc.*, A.2d 503 at 514 (Del. S.C. 1939); *Rosenblum v. Judson Engineering Corp.*, 109 A.2d 558 (N.H. 1954).

[78] *Canadian Aero Services Ltd. v. O'Malley*, [1973] 40 D.L.R. (3d) 371 at 391(S.C.C.).

[79] 80 N.E.2d 522 at 529 (Mass. 1948).

[80] *Miller v. Miller*, 222 N.W.2d 71 (Minn. 1974).

The first step is to determine whether the opportunity is a corporate one. This is done by asking whether it was so closely or intimately associated with the corporation's existing or prospective activities as to fall within its line of business. If the answer is yes, the second step is taken: determining whether the officer who took the corporate opportunity violated his fiduciary duties of loyalty, good faith, and fair dealing towards the corporation. Plaintiff has the burden of proof with respect to the first step; defendant has it with respect to the second.[81]

Similarly, in *Science Accessories Corp. v. Summagraphics Corp.*,[82] the Delaware Supreme Court held:

> Briefly summarized, the law is that if a business opportunity is presented to a corporate executive, the officer can not seize the opportunity for himself if: (a) the corporation is financially able to undertake it; (b) it is within the corporation's line of business; (c) the corporation is interested in the opportunity...A corollary of (this) rule, (however), is that when a business opportunity comes to a corporate officer, which, because of the nature of the opportunity, is not one which is essential or desirable for his corporation to embrace, being an opportunity in which it has no actual or expectant interest, the officer is entitled to treat the business opportunity as his own and the corporation has no interest in it, provided the officer has not wrongfully embarked the corporation's resources in order to acquire the business opportunity.[83]

However Canadian and American courts will allow the officer to take an investment offer where it is clearly shown that the corporation's interest in the offer had ceased at the time the officer took the offer.[84] Thus in *Kaplan v. Fenton*,[85] a month before a director utilized a business opportunity, the corporation had unanimously rejected an identical offer. The court exonerated the director for taking the offer as he had enquired from the corporation's president as to whether he should submit the identical second offer to the board

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[81] Robert Clark, *supra* note 3 at 229.

[82] 425 A.2d 957 (Del. S.C. 1980).

[83] *Ibid.* at 963.

[84] *Peso Silver Mines v. Cropper*, [1966] 58 D.L.R. (2d) 1 (B.C.S.C.).

[85] 278 A.2d 834 (Del. S.C. 1971).

and was answered in the negative.[86] In other words, the corporation's interest in the corporate opportunity had effectively ceased at the time the director utilized the business opportunity.

iv. Corporate Actions with Mixed Motives [87]

Under this rule, the directors are enjoined to exercise their managerial powers in the best interests of the corporation and not with an ulterior motive or purpose.[88] The effect of this duty is more pronounced in takeover bids situations. When faced with hostile takeover bids, the company directors must not use their corporate powers to issue shares to benefit themselves over the outsiders. According to MacCarthy Tetrault:

> Directors' powers, whether derived from statute or the corporate constitution must be exercised for the purpose for which they were conferred....Directors who, in exercising their powers, are motivated by self-interest or some other "improper" or "collateral" purpose, such as a desire to benefit a particular person or group, will be considered to be in breach of their fiduciary obligations. Many of the cases dealing with the exercise of powers for an allegedly improper purpose have concerned directors' attempts to issue corporate shares in order to influence the ability of majority shareholders to exercise voting control.[89]

At common law, there was a complete prohibition on an improper use of corporate powers and if the directors issue shares in order to dilute or override the wishes of majority shareholders, the court will find them in breach.[90] Similarly in Canada, there is in operation

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[86] Edward Welch & Andrew Turezyn, *supra* note 2 at 200.

[87] J. Bird, "Proper Purpose as a Head of Directors' Fiduciary Duty" (1974) 37 Mod. L. Rev. 580.

[88] Robert Clark, *supra* note 3 at 146-147.

[89] MacCarthy Tetrault, *supra* note 1 at 46-47.

[90] *Fraser v. Whalley* (1864), 2 H & M. 10; *Punt v. Symons & Co.*(1903), 2 Ch. 506 (Ch. D.); *Bonisteel v. Collis Leather Co.* (1919), 45 O.L.R. 195 (S.C.); *Smith v. Hanson Tire & Supply Co.*, [1927] 2 W.W.R. 529 (Sask. C.A.); *Hogg v. Cramphorn Ltd.*, [1967] 1 Ch. 254 (Ch. D.); *Howard Smith Ltd. v. Ampol Petroleum Ltd.*, [1974] A. C. 821 (N. S.W. P. C.).

the corporation's best interest approach as stated in *Teck Corporation Ltd. v. Millar.*[91] This requires that where the purpose for which a power was intended to be exercised is not readily ascertainable from the statute or corporate constitution, its exercise by directors will be unimpeachable, regardless of the effect on shareholders' rights, so long as the directors, in exercising the power, acted in good faith in what they believed to be the corporation's best interests, and provided also that there are reasonable grounds for this belief.[92]

The position in the United States of America is the same as in Canada. The corporation's directors are similarly enjoined to consider the corporation's best interests when faced with a hostile takeover bid. The board must expend reasonable effort to secure the highest possible price for the corporation; it must also maximize the value of the company, and if it fails to do so, it has breached its duties to the company and the shareholders. Thus in a takeover bid context, it has also been proposed that the board has a duty to actively solicit additional offers and give legitimate consideration to the offers on the table especially where the board has a financial interest in the outcome. It must not place expensive impediments in the way of one bidder over another, it must discuss all aspects of the sale and merger with each bidder, and while trying to achieve a favourable price for all the shareholders, it must balance the potential for legal problems and unnecessary delays in its

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[91] [1973] 2 W.W.R. 385, 33 D.L.R. (3d) 288 (B.C.S.C.).

[92] See MacCarthy Tetrault, *supra* note 1 at 46-47; The Canadian approach to the role of the directors in this regard is discussed in detail by John Howard in "Takeover Battles and the Business Judgement Rule: Recent American Case Law Development" (1986) 11 Can. Bus. L. J. 445; see also *347883 Alberta Ltd. v. Producers Pipelines Ltd.*, [1991] 3 B.L.R. (2d) 237 at 261 (Sask. C. A.) where it was held that directors facing a hostile take-over bid may take actions in good faith necessary in the corporation's best interests. However, the action taken must be reasonable to the threat posed, for the benefit of the corporation and all the shareholders as a whole, and the action must not interfere with existing rights and privileges nor aimed at entrenching directors.

considerations. The American business corporation laws strictly prohibit the board from competing with the corporation by mandating the directors to disregard personal benefits of its members in its considerations. Nevertheless, the board may delay a bidder where such is in the company's best interest.

Contrarily, Professors Easterbrook and Fischell, ardent proponents of the economic analysis of law theory, have suggested that without market discipline, the executives will run the corporation for their own interests only. They thus submitted that the directors facing a hostile takeover offer have a duty to remain neutral and not to take defensive manoevures.[93] The reasons adduced for this position are that the directors consideration of all bids is beneficial to the company and that it also ensures discipline on the directors.

From Nigeria, the position of the directors facing hostile takeover bids appears open-textured, and it seems that the directors can take any action. The validity of such actions will depend on the circumstances of each case. Thus Dr. Kaiser D. Barnes of Obafemi Awolowo University, Nigeria has submitted that:

> ...the judiciary and legal scholars have formulated divergent views over the operation of the proper purpose duty. It appears that the development of the duty emphasizes a specific equitable limitation on directors' uses of a specific management power over shares. Notwithstanding that the conflicting views regarding the courts' construction of the duty may not be reconciliable, it is clear from the leading proper purpose cases that suitable standards of conduct on the use of a management power by directors is evolving.[94]

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[93] F. H. Easterbrook & D. R. Fischell, "The Proper Role of a Target's Management in Responding to a Tender Offer" (1981) 94 Harv. L. Rev. 1161; F. H. Easterbrook & D. R. Fischell, "Takeover Bids, Defensive Tactics and Shareholders' Welfare" (1981) 36 Business Lawyer 1733.

[94] Kaiser D. Barnes, "Directors' Duty to Allot Shares for a Proper Purpose" (1988) 15 Nig. J. of Cont. Law 27 at 40.

v. Waste of Corporate Assets

Waste of corporate assets is typically an American corporation law concept. It is a hybrid duty which encompasses both the directors duties of loyalty and good faith on the one hand, and the legal competence duty on the other.

It involves situations where the corporate officers use their managerial powers to sell or dispose of corporate property at a very low or minimal value to a person or an entity in which one or more corporate officers or directors have financial interests. Under this rule, the corporation's directors are precluded from wasting corporate assets by accepting a consideration which is so grossly inadequate and disproportionate that no person of ordinary sound business judgement would deem it worth the price which the corporation received for it.[95] This corporate waste doctrine involves the directors duties to act competently in their exercise of business judgement while taking corporate actions in good faith and in the best interests of the company.

The essence of a claim based on waste of corporate assets is the diversion of corporate assets towards improper or unnecessary purposes or the making of a gift out of corporate assets without consideration. The plaintiff's burden in proving that the directors acted improperly is a very difficult one. The determination of whether or not there has been a waste of corporate assets is a question of fact not resting on any hard and fast rule. However, the directors are required to treat the corporation as their own and so should not accept worthless or disproportionate consideration for a sale of its property.[96]

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[95] Edward Welch & Andrew Turezyn, *supra* note 2 at 205-206.

[96] *Saxe v. Brady,* 184 A.2d 602 (Del. Ch. 1962); *Stein v. Orloff*, 574 A.2d 264 (Del. S.C. 1990).

b. The Legal Competence Duty [97]

Sections 282(1) and 117(1)(b) of the CAMA and ABCA respectively provide that the directors act with due care, skill and diligence as a reasonable prudent person in comparable circumstances in the conduct of the corporation's affairs. At common law the level of competence required of a director was atrociously low, [98] as he was only required to act to the best of his subjective individual ability.[99] Under the statutory law the level of competence required is higher and more demanding. Thus MacCarthy Tetrault noted that:

> The level of *care* required by the statutory standard is determined with reference to the care that would be exhibited by a reasonably prudent person in comparable circumstances. In deciding whether a director has met the statutory standard of care, a court will make an inquiry as to what a reasonably prudent person would have done if he or she had been a director of the corporation in question. A reasonably prudent person occupying the position of director would generally be expected to pay careful attention to, and be concerned with, the needs of the corporation. In particular, the duty of care requires that a director bring his or her knowledge, experience and best judgement to bear on the issues of concern to the corporation. It should be noted that a higher standard of care may be expected of persons who in fact possess greater knowledge or skill. Thus, more may be required of directors serving on board committees on the basis that they have some special knowledge or greater access to relevant information and expertise....the level of diligence required of a director or officer is also determined with reference to what a reasonably prudent person would do in comparable circumstances. A reasonably prudent person in the position of a director could be expected at a minimum, to attend *diligently* to the managerial and other duties imposed by statute. The concept of diligence connotes attentiveness, persistence and vigilant *activity;* it is inconsistent with a merely passive or reactive role on the part of directors.[100]

Thus the directors have a duty to be attentive, active and informed in carrying out

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[97] Leo Herzel & Leo Katz, "*Smith v Van Gorkom:* The Business of Judging Business Judgement" (1986) 41 Business Lawyer 1187.

[98] MacCarthy Tetrault, *supra* note 1 at 15.

[99] See *Re City Equitable Fire Insurance Co. Ltd.*, [1924] All E.R. 485 (C.A.); *Re Denham & Co.*(1883), 25 Ch.D. 752 (Ch. D.); *Re Cardiff Savings Bank; Bute's (Marquis) Case*, [1892] 2 Ch. 100 (Ch. D.); *Huckerby v. Elliot*, [1970] 1 All E. R. 189 (C.A.).

[100] MacCarthy Tetrault, *supra* note 1 at 15-16. See also Tamar Frankel, "Corporate Directors' Duty of Care: The American Law Institute's Project on Corporate Governance" (1983-84) 52 Geo. Wash. L. Rev. 705.

their duties.[101] In the U.S.A., there has developed a parallel escape route from directors liability arising from incompetence in the form of the "business judgement rule" which states that courts should refrain from interjecting judicial impositions on business decisions. Thus courts will generally grant significant freedom to businesses to operate as they wish unless there has been a fraud, self-dealing or illegality, and as such they will avoid second guessing or using hindsight to judge the directors legitimate business decisions. In this connection, Professor Robert Clark noted that:

> Nowhere is the tension between the policies of giving managers ample discretion and trying to keep them accountable as obvious as in the cases invoking the duty of care, the business judgement rule, or both. Statutes and case law say that directors and officers owe their corporations a duty of care: they must exercise that degree of skill, diligence and care that a reasonably prudent person would exercise in similar circumstances. At times, some authorities have applied the stricter formulation that the director or officer must act as a reasonably prudent person would act in the conduct of his own affairs...In contrast to this worrisome doctrine, the mere mention of the business judgement rule is just a corollary of the usual statutory provision that it is the directors who shall manage the corporation. The rule is simply that the business judgement of the directors will not be challenged or overturned by courts or shareholders, and the directors will not be held liable for the consequences of their exercise of business judgement-even for judgements that appear to have been clear mistakes...[102]

However a director must be attentive, vigilant, laborious, persistent, and concerned, while at the same time paying paying due attention in managing the corporation's affairs as the presumption of business judgement may be overturned by clear evidence of recklessness.[103]

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[101] *Ibid.*

[102] Robert Clark, *supra* note 3 at 123. See also Allen M. Terrell, Jr., "Bricks for the Business Judgement Citadel-Recent Developments in Delaware Corporate Law" (1984) 9 Del. J. of Corp. L. 329; Allen M. Terrell, Jr. & Samuel A. Nolen , "Recent Developments in Delaware Corporate Law" (1983) 7 Del. J. of Corp. L. 407.

[103] *Smith v. Van Gorkom* 488 A.2d 858 (Del. S.C. 1985). A more detailed discuss on the Business Judgement Rule follows in chapter 4 of this paper. See also Leo Herzel and Leo Kartz, "*Smith v. Van Gorkom*: The Business of Judging Business Judgement" (1986) 41 Business Lawyer 1187.

c. Insider Trading

The Alberta *Securities Act*[104] (hereinafter "the ASA"), ABCA [105] and CAMA [106] all prohibit insider trading by the corporate officers and directors with knowledge of confidential material information not generally disclosed.[107] Thus the *Kimber Committee Report* noted that:[108]

> The ideal securities market should be a free and open market based upon the fullest possible knowledge of all relevant facts among traders. Any factor which tends to destroy or put in question this concept, lessens the confidence of the investing public in the market place and is, therefore, a matter of public concern.[109]

The insider trading prohibition is one of the instances whereby the directors breach their duties to the corporation and the shareholders. The ASA in section 119 prohibits insider trading, and it identifies insider trading as a situation where an insider[110] or any other person who stands in a confidential relationship[111] with the corporation sells or purchases the

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[104] S. A. 1981, c. S-6.1., at ss 1(i), 9, & 119.

[105] See ABCA, ss 121-125.

[106] See CAMA, ss 614-621.

[107] For a detail information on the insider trading regulations in Nigeria , Canada and the U. S. A. see Ogochukwu Victor Onwaeze, *A Comparative Appraisal of Insider Trading Regulations in Nigeria,* (A Thesis Submitted to the Faculty of Graduate Studies and Research, University of Alberta, in partial fulfilment of the requirements for the degree of Master of Laws.) (Edmonton, Alta: FGSR, 1992).

[108] The Kimber Committee Report, *Report of the Attorney General's Committee on Securities Legislation in Ontario*, (March 11, 1965).

[109] *Ibid.* at 2:02.

[110] Under section 1(i) of the ASA, an insider includes the director, senior officer or a person or company who exercises or owns more than 10% of the corporation's securities.

[111] Section 9(c) of the ASA specifies that a director, officer or employee of the corporation or its subsidiary or affiliate stands in a confidential relationship with the corporation.

corporation's securities with knowledge of a confidential material fact[112] or material changes[113] which has not been generally disclosed.[114]

In *Multiple Access Ltd. v. McCutcheon,*[115] the Canadian Supreme Court identified insider trading as:

> [T]he purchase or sale of the securities of a company by a person who, by reason of his position in the company, has acess to confidential information not known to other shareholders or the general public.[116]

In the United States of America, section 16(b) of the *Securities Exchange Act*[117] similarly prohibits an insider from trading in the corporation's securities based on material confidential information which results in a "short-swing profit," within 6 months of the purchase or sale whichever is later.[118] Thus in *Tongue v. Vencap Equities Alberta Ltd.*[119] the directors of the corporation were held jointly and severally liable, under section 125 of the

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[112] Under section 1(l) of the ASA, a material fact is such fact that will have or reasonably be expected to have a significant effect on the market price or value of the securities, or one that an average investor will deem reasonably necessary in making his investment decision.

[113] Under section 1(k.1) of the ASA, a material change is such a change in the affairs, business or operation of the corporation that has or will be reasoably be expected to have a significant effect of the market price or value of the securities.

[114] See generally Louis Loss & Joel Seligman, *Fundamentals of Securities Regulation,* 3rd. ed., (Boston: Little, Brown & Co., 1995) at 552-591; Victor P. Alboini,*Ontario Securities Law* (Toronto: Richard de Boo Ltd., 1980) at 752-797; Louis Loss, *Fundamental of Securities Regulation,* 2nd.ed., (Boston: Little, Brown Ltd., 1988) at 541-582.

[115] [1982] 2 S.C.R. 161.

[116] *Ibid.* at 164.

[117] *U. S. Securities Exchange Act* of 1933.

[118] See Robert Clark, *supra* note 3 at 293-309.

[119] (1996), [1996] 6 W.W.R. 761 (Alta. C.A.), *aff'g* [1994] 5 W.W.R. 674 (Alta. Q. B.).

ABCA as concurrent tortfeasors,[120] to the minority shareholders in the corporation from whom they had purchased shares without disclosing material confidential information which they learnt by virtue of their office.

Cases where the directors breached their duties resulting in corporate injuries or losses which either directly or indirectly affected the corporate interests of the minority shareholder and which adversely led to situations that the minority wished that the corporation should take action against the offending directors grew in number. In such situations, the minority shareholder's grievances were frustrated either because the erring directors themselves controlled the managerial powers including powers to commence legal action for redressing corporate wrongs, or at the same time they were the majority so that they frustrated the efforts of the minority to appoint an independent board that would have commenced such remedial actions. All attempts to enforce the company's rights met the brickwall because of the larger than life common law legal rule known as the rule in *Foss v. Harbottle*.[121]

V. The Rule in *Foss v. Harbottle*

This *Foss v. Harbottle* case laid down the theoretical basis for the enforcement of directors duties. The rule provides that whenever it is alleged that a wrong has been committed against the corporation (e.g. a breach of duty by the directors) the proper plaintiff

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[120] For breach of their fiduciary duties.

[121] (1843), 2 Hare 461; 67 E.R. 189 (Ch. D.). The liability of directors and the enforcement of thedirectors' duties however received substantial boost in recent times via modern business corporations legislations and the supportive judicial attitude to the injured minority shareholders. See R. D. Fischell and M. Bradley, "The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis" (1985-86) 71 Cornell L. Rev. 261.

in an action to redress that wrong is prima facie the corporation itself. If the wrong is a mere irregularity which can be regularized, ratified or made binding on the company by the majority members, no member or group of members will be allowed to sue in respect of it. Commenting on this rule Professor Oladeji Akanki noted that:[122]

> [T]his, in turn, is derived from a misconception at the time of the original formulation of the law that joint-stock company is a kind of partnership..

This partnership law based rule (under the partnership law, the English courts would generally not interfere in the partnership business except to dissolve the partnership)[123] is twofold in nature. The first is the proper plaintiff rule which stems mainly from principle of distinct corporate personality stating that once you confer legal personality on the corporation it follows that its rights and duties belong primarily to it.[124] In this regard the corporation, a person for all purposes, acts only through the board of directors or persons duly authorized by the board.[125] As a result, any action commenced on the instructions of a shareholder, purportedly on the corporation's behalf, will be struck out.[126] The second ambit of the rule

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[122] See E. Oladeji Akanki, "Reformulating the Law Against Oppression in Companies" (1990/91) 13, 14 & 15 The Journal of Private & Property Law 19. See also S. Chumire, "Challenging Directors and the Rule in *Foss v. Harbottle*" (1965) 4 Alta. L. Rev. 96.

[123] K.W. Wedderburn ,"Shareholders' Rights and the Rule in *Foss v. Harbottle*" (1957) Cam. L. J. 194, at 196; *Carlen v. Drury* (1812), 35 E.R. 61 at 62.

[124] But note that only the Directors have powers to commence legal action on behalf of the corporation: *Atewologun v. Metro Motors* (1978), 2 L. R. N. 46 (Nig. F.H.C.); *Shaw & Sons Ltd. v. Shaw,* [1935] All E.R. 456 (C.A.).

[125] *John Northway & Son Ltd. v. Dunwoody* (1962), O.W.N. 112 (H.C.); *Port Darlington Harbour Co. v. Dilling* (1975), 66 D.L.R. 640 (Ont. S.C.).

[126] See Gordon Phillips, *Personal Remedies for Corporate Injuries* (Scarsborough: Carswell, 1992) at lix-lxiii; O. A. Osunbor,"The Enforcement of Directors' Duties-New Dimension in the Companies and Allied Matters Decree 1990" (Paper Presented at a Workshop "Issues of Corporate Management and Finance in the Companies and Allied Matters Decree1990, Held at Obafemi Awolowo University, Ile-Ife, Nigeria, March 19-21,1991.) (Unpublished). See also D. D. Prentice, "Shareholder Actions: the Rule in *Foss v. Harbottle*"

"the internal management rule" is drawn from a partnership law analogy. In this regard, Professor Osunbor noted:

> [T]he attitude of common law courts toward a partnership was that in matters concerning the ordinary business of the firm the wishes of the majority should prevail since the partners, not the courts, are best placed to decide on a business matter. The majority having decided one way or another, it was not open to a minority shareholder to question it since he has the option of taking out his stake in the business. Thus where a wrong or a breach is ratifiable by the majority, a minority shareholder is precluded from suing on it.[127]

The minority shareholder thus has the choice to either eat his humble pie when he suffers injury from the way the corporation is being run or take the drastic step of asking the court to wind up his corporation.[128] Section 299 of the CAMA attempts to codify the rule in *Foss v. Harbottle* as follows:

> Subject to the provisions of this Decree, where irregularity has been committed in the course of a company's affairs or any wrong has been done to the company, only the company can sue to remedy that wrong and only the company can ratify the irregular conduct.

In the view of the Nigerian Law Reform Commission:

> There was a forceful argument that the shareholders have a general right to enforce all the provisions in the articles....the fact still remains that non-observance of the terms of the articles and the provisions of the Companies Act is a wrong done to the company itself except in certain circumstances where an individual shareholder is wronged personally.....[129]

(1988) 104 L. Q. R. 341.

[127] See O. A. Osunbor *supra* note 126 at 4. The struggle between the recognition of the minority's rights and the sanctity of the board's managerial powers has been the subject of legal discuss over the years. See for instance, A. J. MacIntosh, "Corporate Governance and Minority Rights" (1983) 7 Dalhousie L. J. (No. 3) at 42; J. G. MacIntosh, "Minority Shareholders' Rights in Canada and England 1860-1987" (1989) 27 Osgoode Hall L. J. 561; S. K. Miller, "Minority Shareholder Oppression in the Private Company in the European Community: A Comparative Analysis of Germany, United Kingdom, and the French" (1997) 30 Cornell Int. L. J. (No. 2) at 381.

[128] E. Oladeji Akanki, *supra* note 122 at 19; see also *Ebrahimi v. Westbourne Galleries Ltd.*, [1972] 2 All E.R. 492 (H.L.).

[129] *Nigerian Law Reform Commission's Working Papers on the Reform of Nigerian Company Law*, (Review and Recommendations) Vol. 1 (Lagos: NRLC, 1988) at 232-233 and at para. 4.

There is no similar provision in the ABCA, since Alberta corporation jurisprudence is a "division of powers" model.[130] However, by providing for various shareholders remedies in the whole of Part 19 thereof, it has impliedly recognized that without such provisions the rule in *Foss v. Harbottle* inherited from English common law might operate to shut out the aggrieved shareholder in an appropriate case.

VI. The Rationale Behind the Rule in *Foss v. Harbottle*

There are at least eight recognized legal theories behind the rule in *Foss v. Harbottle*:

a. Preventing Multiplicity of Actions

It was thought that there would be an avalanche of suits that would involve the company in unnecessary expenses and frivolity without such a restriction. For example, all the numerous shareholders would each have a right of action against the third party, after which it would reach the turn of the creditors, the guarantors, employees and so on. According to Gordon Phillips, "cases making this point are too numerous......the line has to be drawn somewhere."[131]

b. Preventing Futility of Actions

According to Mellish, L.J. in *MacDougall v. Gardiner*:

> If the thing complained of is a thing which in substance the majority of the company are entitled to do...or if something has been done illegally which the majority .....are entitled to do legally, there can be no use in having a litigation about it, the ultimate end of which is only that a

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[130] See Bruce Welling, *supra* note 8 at 297-301. Under the "division of powers" jurisdiction as opposed to the "contractarian" or "memorandum"jurisdiction, the powers, duties and functions of the different corporate players-the shareholders, directors, officers are conferred statutorily and are not derived from any corporate contract or agreement.

[131] See Gordon Phillips, *supra* note 126 at 11- 12.

meeting has to be called and then ultimately the majority gets its wishes.[132]

This rationale has deep roots in English partnership law, the forerunner of English company law, which provides that where the act alleged or the irregularity can be ratified or regularized by a majority of the members, then an action by the minority will be futile. In the words of Gordon Phillips:

> ...at any time, the company by vote of its members, might forgive or 'ratify' the defendant's acts. The plaintiff shareholder could probably not prevent this: almost certainly she cannot muster enough votes to pass a resolution that the company bring its own action (if it could, there would be no need for her to bring her own action).....hence there is a serious risk that by the time the shareholder's action goes to trial a corporate resolution will have been passed that eliminates the wrongfulness of the defendant's act, upon which she must rely.[133]

Under this rule courts will not interfere in internal management of the company. In *North-West Transportation Co Ltd. v. Beatty,*[134] a sale by a director to the corporation at a proper price for its business purposes was made binding on the corporation by a majority of votes at the general meeting. Also in *Regal (Hastings) Ltd. v. Gulliver,*[135] the purchase of shares in a subsidiary which yielded profit to the directors was held ratifiable.

c. Prevention of Double Recovery

In the United States of America, shareholders have been denied standing on the need to prevent double recovery.[136] The rationale is that the corporation has an accrued legal right

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[132] [1875] 1 Ch.D. 13 at 25 (Ch. D.).

[133] See Gordon Phillips, *supra* note 126 at 33; *Pavlides v. Jensen,* [1956] Ch. 565 (C.A.).

[134] (1887), 12 App. Cas. 589 (P.C.).

[135] [1967] 2 A.C. 134n (H.L.); *Queensland Mines v. Hudson* (1978),52 A.L.J.R. 399(P.C.); contrast *Cook v. Deeks,* [1916] 1 A.C. 554 (P.C.).

[136] *Niles v. New York Central and H.R. Railway Co.,* 68 N.E.142 at 144 (N.Y.C.A. 1903); *George Hudson Pty Ltd v. Bank of New South Wales* (1978), 3 A.C.L.R. 366 at 369.

of recovery for the wrong done to it which is to the same value as the loss occasioned by the wrong. For example, where the corporation loses $40,000 due to the wrongful act, it then has a legal right of action for the sum of $40,000 in law, that is a cause of action worth $40,000 in which a shareholder has an indirect interest by being a member of the corporation. In the eyes of the law, to permit a private shareholder to commence a separate action for $40,000 for a direct benefit would lead to double recovery.[137]

d. Prevention of Vetos over the Corporation's Negotiations

There is need to ensure that every shareholder is bound by all legitimate and informed corporate decisions of the directors whenever there is a *bona fide* amicable settlement or release with a third party. Without this, a third party who settles with a corporation does so at his own risk as he may be subject to further proceedings by various shareholders in spite of the earlier settlement proceedings. It is thus necessary for every member to be bound through the form of the corporation's legal personality.

e. Prevention of Abusive Proceedings

In America "strike suits," (i.e. actions brought for improper or abusive purposes) have always been frowned at through "strictures on derivative suits." To leave private shareholders with total liberty without any legal constraints is an invitation to professional litigants and busybodies. In *Ash v. I.B.M.,*[138] the court held:

> Indeed, were the rule otherwise the distinction between a stockholder's derivative claim and a claim in his primary right would disappear, and the public policy based strictures on derivative suits could be avoided merely by asserting that economic harm to a corporation in itself

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[137] See Gordon Phillips, *supra* note 126 at 14-33.

[138] 353 F.2d 491 (3d Cir. 1965); see also *Rose v. Shantz* , 201 N.W. 3d 593 (Wis. S.C. 1972).

constituted justiciable personal injury to each owner of stock in the corporation.[139]

While in *Cohen v. Beneficial Insurance Loan Corp.*,[140] Jackson, J. held:

> Unfortunately, the remedy (of derivative suit) itself provided for abuse which was not neglected. Suits were brought not to redress real wrongs, but to realize upon their nuisance value. They were bought off by secret settlements in which any wrongs to the general body of share owners were compounded by the suing stockholder, who was mollified by payments from corporate assets. These litigations were aptly characterized in professional slang as 'strike suits'. And it was said that these suits were more commonly brought by small and irresponsible than by large stockholders, because the former put less to risk and a small interest was more often within the capacity and readiness of management to compromise than a large one.[141]

f. The Doctrine of Privity of Contract and Benefit/Burden Principle

It is a fundamental rule of law that only parties to an action can take its benefit and simultaneously bear the burdens arising therefrom, and so where there is a breach of contract only the corporation which has furnished consideration in its support has the right to enforce an action. Also a situation in which a private shareholder may enforce the benefit of a corporate right and then turn around to shield behind limited liability protection under the corporation's legal personality to escape its burden being enforced against him definitely smirks of injustice and double standard.[142] Since the shareholders have consented to be joined together under the corporate form from which, if a corporation commits legal wrongs, they cannot be reached, they are also precluded from turning around to obtain corporate legal benefits as partners in a firm. This position is supported by the court in *MacDonald v.*

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[139] See *Ash v. I.B.M.*, 353 F.2d 491 at 494 (3d Cir. 1965).

[140] 337 U.S. 1221 (1949).

[141] *Ibid.* at 1226-1227.

[142] See Gordon Phillips, *supra* note 126 at 40-42.

Bennett, that:[143]

> Having chosen to conduct his affairs through use of the corporate vehicle, with all of the benefits traditionally conferred by that device, he cannot simply shrug off the corporate mantle at the courthouse steps and demand recovery of all his losses as a private individual.[144]

I. The Beginning of Minority Oppression in Corporations

In evaluating the efficacy of the above theories in solving the problems surrounding enforcement of corporate rights, the opinion of Akanki is relevant here:

> ... law is like technology which seeks the manageable problems. If it cannot solve a particular problem it reformulates it in such a way that a solution is possible..[T]he reason why law may not solve a particular problem is due to self-induced maladies....based on a mere perception of the problem it seeks to solve. But perceptions are a blind alley as they are never based on actual facts. When true facts emerge the law has to change its approach.[145]

That the English common law courts' adherence to strict observance of the corporate personality rule will not be beneficial on the long run is made more manifest in *Ebrahimi v. Westbourne Galleries Ltd.*,[146] where Lord Wilberforce noted:

> The words are a recognition of the fact that a limited company is more than a limited judicial entity, with a personality in law of its own: that there is room in company law for the recognition of the fact that behind it, or amongst it, there are individuals, with rights, expectations and obligations inter se which are not necessarily submerged in the company structure.[147]

The rights and expectations of the separate corporate players which are not submerged in the corporate structure have been trampled upon, emasculated, disregarded and abused at various times under the rule in *Foss v. Harbottle* which effectively shut out

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[143] 647 F.2d 1080 (U.S.C.A. 2d Cir. 1982).

[144] *Ibid.* at 1086.

[145] See E. Oladeji Akanki, *supra* note 122 at 19; see also Jesse Dukemier, Jr.," The Coming Search for Quality" (1964-65) 12 U. C. L. A. L. Rev. 707.

[146] [1972] 2 All E.R. 492 (H.L.).

[147] *Ibid.* per Lord Wilberforce at 499-500.

shareholders from the courts.Thus Professor Osunbor noted that:

> [C]ompany law has vested immense powers on company directors which make it extremely difficult for their conduct to be questioned by others, whether shareholders, liquidators, third parties......[T]he rule in *Foss v Harbottle* has constituted a hinderance to the enforcement of director's duties for a long time now.[148]

In effect minority shareholders discovered that the effect of the rule in *Foss v. Harbottle* was that their standing to ensure that the directors were held accountable to the corporation was either non-existent or virtually regulated out of existence.[149] The result was that the minority became more and more frustrated with each decided case at the common law courts.

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[148] See O. A. Osunbor, *supra* note 126 at 14; See also H. Rasak, "Oppression of Minority Shareholders" 35 Mod. L. Rev. 1; R. J. Smith, "Minority Shareholders and Corporate Irregularities" (1978) 41 Mod. L. Rev. 147; L. S. Sealy, "A Setback for the Minority Shareholder" (1982) Cam. L. J. 247.

[149] See *The Law Reform Commission (British), Shareholder Remedies, A Consultation Paper (Consultation Paper No 142.)* (London: Stationery Office, 1996) at 1-3. See also K. W. Wedderburn, "Derivative Actions and *Foss v. Harbottle*" (1981) 44 Mod. L. Rev. 202; K. W. Wedderburn, "Shareholders' Rights and the Rule in *Foss v. Harbottle*" (1957) Cam. L. J. 194.

CHAPTER 2

STATUTORY REFORMS IN CANADA AND NIGERIA

I. Introduction

The post *Foss v. Harbottle* corporation law witnessed a sharp curtailment of the minority shareholder's rights in England. This in turn led to the creation of common law exceptions. These exceptions were aimed at protecting the minority shareholder's rights in the administration and management of a corporation that had become endangered and subject of greater strain as a result of the increase in the powers vested on the corporate managers and directors, and in the growing emphasis by the courts on their lack of power to interfere with the internal management of corporations.[1]

The pervasive influence of the English majority rule in *Foss v. Harbottle* had effectively curtailed all the shareholders grievances. Efforts to assert corporate rights and claims regarding the directors breaches of their duties of care and loyalty to the corporation and the shareholders were aborted.[2] This resulted in more vigorous efforts to find ways to circumvent the long arms of the rule in *Foss v. Harbottle*. Thus Professor Gower noted that:

> The rule in *Foss v. Harbottle* has been vigorously criticised by commentators over the years, and the question of its reform has been referred to the Law Commission. It has been said to restrict too narrowly the individual shareholder's power to enforce the company's rights; to have resulted in an overly complex body of rules; to pursue inconsistent policies; and to have been extended beyond its proper scope.[3]

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[1] Robert Baxt," Status and Duties of Company Directors by J.A. Olawoyin" (Book Review.) (1978-79) 3 Can. Bus. L. J. 358.

[2] Ivan R. Feltham, Q.C. & William R. Rauenbusch, " Directors' and Officers' Liabilities in Canada" (1975-76) 1 Can. Bus. L. J. 321 at 334.

[3] Paul L. Davies, ed., *Gower's Principles of Modern Company Law*, 6th ed., (London: Sweet & Maxwell, 1997) at 659-660.

The need to regulate the unlimited and unrestricted power of the board and the controlling shareholders in their use of the corporate powers to feather their own nest alone to the detriment of the minority is the subject for consideration in this chapter.

II. The Minority Shareholder

A derivative action is a suit brought, usually by the minority shareholder, in the name of a company to recover corporate property or enforce the rights of the company, in situations where the directors or managers have refused to do so.[4] Although there is no definition of the minority shareholder in the CAMA and ABCA, a working definition was that adopted by the Nigerian Law Reform Commission as follows:

> It is important to explain the term 'minority' at the outset to ensure a full appreciation of who are actually sought to be protected. The term is nowhere defined in Companies Act (1968) but its meaning could be discerned from the cases. Minority here relates to the number of votes and the quantum of voting power possessed by members, and does not necessarily relate to the numerical strength of members. Where there is no provision for voting by poll, that is, where voting is by show of hands, the number of persons who win the motion on a simple majority vote are the majority, and those who vote against the motion are the minority. If however, a poll is demanded, those holding more voting power will be the majority, even if they are fewer in number than those with less voting power. For example, where a company issued 3,000 N1 ordinary shares, and three persons out of five hold between them 1,348 shares, they are the minority shareholders while the other two persons holding 1,651 shares between them are the majority shareholders. Consequently, numerical majority shareholders may in fact be the minority shareholders to be protected.[5]

A person or a group of persons within the corporation falls into the minority group either by having fewer voting power (in case of a poll vote) or being outnumbered by the other group (in case of voting by show of hands).

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[4] See Scott A. Turner, "Shareholders' Remedies: Commencing a Derivative Action in British Columbia" in *Shareholders' Remedies,* (Materials Prepared for the Continuing Legal Education Seminar, *New Developments in Shareholders' Remedies,* Held in Vancouver, B. C. on November 28, 1996.) at 1.1.03.

[5] *Nigerian Law Reform Commission's Working Papers on the Reform of Nigerian Company Law,* (Review and Recommendations) Vol. 1 (Lagos: NRLC, 1988) at 233.

III. The Common Law Exceptions

Traditionally, the common law courts created exceptions to the rule in *Foss v. Harbottle,* and these have now been incorporated into section 300 of the CAMA.There is no similar provision under the ABCA (a division of powers model) probably due to the fact that much of the statutory reforms of the 1970s to the Canadian business corporation laws were aimed at abolishing the old inconsistent common law judge-made rules and adopting the American workable "procedural remedies" only. In *Foss v. Harbottle*[6] itself, Wigram, V.C. had opined that the principle barring the minority from an action is not inflexible and that in appropriate cases, a minority will be permitted to sue to redress a corporate wrong :

> If a case should arise of an injury to a corporation by some of its members, for which no adequate remedy remained except that of a suit by independent corporators in their private characters, and asking in such a character the protection of those rights to which in their corporate character they were entitled, I cannot but think that the principles so forcibly laid down by Lord Cottenham in *Wallworth v. Holt* and other cases would apply, and the claims of justice would be found superior to any difficulties arising out of technical rules respecting the mode in which corporations are required to sue.[7]

Over the years a number of exceptions,[8] about four, have been recognised at common law.[9] These exceptions are now codified in the CAMA unlike the ABCA which follows the

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[6] (1843), 67 E.R. 189; 2 Hare 461 (Ch.D.).

[7] (1843), 67 E.R. 189 at 203 (Ch.D.).

[8] *Edwards v. Halliwell,* [1950] 2 All E.R. 1064 at 1066-1069 (C.A.); *Prudential Assurance Co.Ltd. v. Newman Industries Ltd. (No. 2),* [1982] Ch. 204 (C.A.).

[9] Robert Pennington, *Penington's Company Law,* 7th ed., (London: Butterworths, 1995), at 871-885; See also Professor O. A. Osunbor,"The Enforcement of Directors' Duties-New Dimensions in The Companies and Allied Matters Decree 1990" (A Paper Presented at a Workshop on Issues of Corporate Management and Finance in the Companies and Allied Matters Decree 1990 at Obafemi Awolowo University, Ile-Ife, Nigeria held from 19th -21st March, 1991) (Unpublished) at 4-6. The CAMA in section 300 (a) to (f) makes elaborate provisions for these common law exceptions unlike the ABCA, and this is diametrically opposed to the North American approach.

American corporations law approach strictly. Professor Osunbor had identified the problems associated with these judge - made exceptions as follows:

> Until the promulgation of the CAMA the rule in *Foss v. Harbottle* along with its exceptions in Nigeria were to be found in a vast number of cases. Unfortunately many of these cases are so difficult to reconcile with others that the true ambit of the rule remains unsettled. It is hoped that by codifying the rule, the Decree (CAMA) has laid the foundation for substantially simplifying this aspect of the law in future, although much will depend on how consistent the courts are in interpreting and applying the law, especially the procedural requirements.[10]

To this end Section 299 of the CAMA now provides thus:

> Subject to the provisions of this Decree, where irregularity has been committed in the course of a company's affairs or any wrong has been done to the company, only the company can sue to remedy that wrong and only the company can ratify the irregular conduct.

Further section 300 of the CAMA also provides:

> Without prejudice to the rights of the members under sections 303 to 308 and sections 310 to 312 of this Decree or any other provisions of this Decree, the court, on the application of any member, may restrain the company from the following-
>
> (a) entering into any transaction which is illegal or *ultra vires*;
>
> (b) purporting to do by ordinary resolution any act which its constitution or the Decree requires to be done by special resolution;
>
> (c) any act or omission affecting the applicant's individual rights as a member;
>
> (d) committing fraud on either the company or the minority shareholders where the directors fail to take appropriate action to redress the wrong done;
>
> (e) where a company meeting cannot be called in time to be of practical use in redressing a wrong done to the company or to the minority shareholders; and
>
> (f) where the directors are likely to derive a profit or benefit, or have profited or benefited from their negligence or from breach of duty.

What follows is a discussion of these provisions.

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[10] See O. A. Osunbor, *supra* note 9 at 5.

a. The *Ultra Vires* or Illegal Act Exception

There can be no justification for the corporation acting *ultra vires* or seeking to perform an illegal act. In *Parke v. Daily News,*[11] the court upheld the minority shareholder's objection contending as illegal and *ultra vires* a scheme prepared by the directors to pay out the purchase money realised from the sale of the corporation as compensation and pension benefit. This rule allowing the minority access to the courts to restrain the use of the corporation's resources in the performance of an illegal or *ultra vires* transaction has its root in the *ultra vires* doctrine laid down in *Ashbury Railway Carriage Co. v. Riche,*[12] and it is now contained in Section 300(a) of the CAMA.

b. The Special Majority/Procedure Exception

Section 300(b) of the CAMA recognizes the right of a minority shareholder to obtain an injunction or a declaration to restrain the directors from purporting to do by an ordinary resolution or ordinary procedure an act required by the corporate constitution or CAMA to be done by a special procedure or special resolution. In *Edwards v. Halliwell*[13] for example, a decision of the trade union executive committe that was passed contrary to the trade union two-thirds requirement in its bylaw was set aside by the court at the instance of the minority.[14]

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[11] (1962), Ch. 927 (C.A.); See also *Anderson v. Midland Railway* (1902), 1 Ch. 369 (Ch. D.).

[12] (1875), L.R. 7 H.L. 653. It should be noted that under the new corporation laws in both Nigeria and Alberta the common law *ultra vires* rule is now outdated and abolished, for example sections 39(3) and 16(3) of the CAMA and ABCA respectively provide that the a corporation act shall not be invalid solely because it is not approved in the corporation's constitution. For a detailed study of the applicability of the *ultra vires* rule in Canada see *Communities Economic Development Fund v. Canadian Pickles Corporation,* [1991] 3 S.C.R. 388.

[13] [1950] 2 All E.R. 1064 (C.A.).

[14] See also *Baillie v. Oriental Telephone Co.*, [1915] 1 Ch. 503 (C.A.); *Quin & Axtens v. Salmon,* [1909] 1 Ch.311 (C.A.).

Jenkin, L.J. had noted that:

> If the matter in respect of which he was suing was one which could validly be done or sanctioned, not by a simple majority of the members of the company or association, but only by some special majority, as for instance, in the case of a limited company under the Companies Act, a special resolution duly passed as such......the reason for that exception is.....if the rule were applied in its full rigour, a company which, by its directors, had broken its own regulations by doing something without a special resolution could assert that it alone was the proper plaintiff in any consequent action and the effect would be to allow a company acting in breach of its articles to do de facto by ordinary resolution that which according to its own regulations could only be done by special resolution.[15]

This is similar to an actual or threatened breach of the company's articles of incorporation and by-laws under the ABCA which can be remedied by a shareholder suit under section 240 dealing with the compliance and restraining order.[16]

c. The Personal Right Exception

Section 300(c) of the CAMA provides that when the personal right of a member is affected by the directors wrongful acts, he has a right to apply to the court for an injunction or a declaration. In *Pender v. Lushington,* [17] the minority member's proposition was overruled at a general meeting and his vote was not recorded. The proposed resolution that would otherwise have been carried was declared lost. In an action, the court upheld his claim for a declaration to have his votes recorded. Jessel, M.R. noted that the minority's personal right had nothing to do with the question like that raised in *Foss v. Harbottle* cases.[18] In the

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[15] See *Edwards v. Halliwell,* [1950] 2 All E.R. 1064 at 1067 (C.A.).

[16] See Robert Pennington, *supra* note 5 at 872. However under the ABCA, section 244 provides that anybody who fails to comply with any of the ABCA provisions and regulations shall be guilty of an offence. Whether this can be utilized to compel directors to adhere to the provisions of the constating documents.

[17] (1877), 6 Ch.D. 70 (Ch. D.).

[18] *Ibid.* per Jessel, M.R. at 80; *Cotter v. National Union of Seamen,* (1929), 2 Ch. 58 (Ch. D.).

Nigerian case of *Nigerian Stores Workers Union v. Uzor,*[19] the court ruled that the minority has a right of action where his personal right conferred by the corporation's articles of incorporation has been infringed or violated. In the same line, Duff, J. noted in *Theartre Amusement Co. v. Stone* that:[20]

> The articles of association are binding upon the company, directors and the shareholders, until changed in accordance with the law. So long as they remain in force, any shareholder is entitled, unless he is estopped from taking that position by some conduct of his own, to insist upon the articles being observed by the company, and the directors of the company. This right he cannot be deprived of by the action of any majority. In truth, the articles of association constitute a contract between the company and the shareholders which every shareholder is entitled to insist upon being carried out.[21]

d. The Fraud on the Minority Exception

Section 300(d) CAMA allows the minority shareholder to go to court where the wrongful act of the directors constitutes a fraud either on the company or the minority, and the directors have failed to take appropriate action to redress the wrong. This exception has been in existence as long as the rule in *Foss v. Harbottle* itself. There Wigram, V.C. held that:

> ...the claims of justice would be found superior to any difficulties arising out of technical rules respecting the mode in which corporations are required to sue.[22]

In *Menier v. Hooper's Telegraph Works,*[23] the majority shareholder used its votes to procure a diversion of contracts meant for the corporation to another corporation in which it held substantial interest and later caused an abandonment of proceedings brought by other

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[19] (1971), 2. N.C.L.R. 412 (Nig. S.C.).

[20] (1914), 50 S.C.R. 32.

[21] *Ibid.* at 36-37.

[22] See Wigram, V.C. in *Foss v. Harbottle* (1843), 67 E.R. 189 at 203 (Ch. D.).

[23] (1874), 9 Ch. App. 350 (C.A.).

members to recover corporate property from the improper transsaction. James, L.J.[24] referring to *Atwool v. Merryweather,*[25] held that the acts constituted fraud on the minority members, and so can not be shielded by the rule in *Foss v. Harbottle,* and so held that the minority's suit as being properly brought in the circumstances. Similarly in *Alexander v. Automatic Telephone Co.,*[26] where the directors resolved that the largest shareholders in the corporation should pay a lesser sum for their allotment, a declaration directing all the members to pay equal prices was granted.Cases like *Cook v. Deeks,*[27] and *North-West Transportation Ltd. v. Beatty,*[28] were decided along the same line, as it will be a long wait to expect the majority shareholders who are also the wrongdoing directors to take action against themselves for redress in favour of the minority.

Similarly in the U.S.A., where the alleged wrongdoers had engaged in basic self-dealing against their corporation or had usurped a corporate opportunity, the minority are allowed to sue derivatively as "no one would expect the defendant directors to give adequate consideration to a shareholder demand for a corrective action."[29]

In recent times courts have recognized the complexity surrounding this exception and have gone on to enlarge the scope of wrongful acts that will constitute fraud on the minority.

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[24] *Ibid.* per James, L. J. at 361.

[25] (1867), L. R. 5 Eq 464n.

[26] [1900] 2 Ch. 56 (C.A.).

[27] [1916] 1 A.C. 554 (P.C.).

[28] (1887), 12 A.C. 589 (P.C. Ont.).

[29] Robert Clark, *Corporate Law* (Boston: Little, Brown & Co., 1986) at 641-642.

The operative words for this exception are *fraud* and *control*. Thus in *Prudential Assurance Co Ltd. v. Newman Industries Ltd. (No.2),*[30] the court held that:

> There is an exception to the rule in *Foss v. Harbottle* where what has been done amounts to fraud and the wrongdoers are themselves in control of the company. In this case the rule is relaxed in favour of the aggrieved minority, who are allowed to bring a minority shareholders' action on behalf of themselves and all others. The reason for this is that, if they are denied that right, their grievance could never reach the court because the wrongdoers themselves, being in control, would not allow the company to sue.[31]

In *Estimanco (Kilner House) Ltd. v. Greater London Council,*[32] Sir Robert Meggary, V-C. expanded the meaning of *fraud* as " ....fraud in the wider equitable sense of that term."[33] In *Burland v. Earle,*[34] Lord Davey held *fraud* by majority to encompass acts:

> ...where the majority are endeavouring directly or indirectly to appropriate to themselves money, property or advantages which belong to the company or in which other shareholders are entitled to participate...[35]

In the *Estimanco Case,*[36] the court presumed fraud where the directors converted the corporation's block of flats to their own use in breach of corporate agreements. The definition of fraud laid down in *Daniels v. Daniels*[37] was adopted. There Templemann, J. held that fraud is evident:

> ..where the action of the majority and the directors, though without fraud, confers some benefit

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[30] [1982] Ch. 204 (C.A.).

[31] *Ibid.* at 211.

[32] [1982] 1 W.L.R. 2 (Ch.D.).

[33] *Ibid.* at 12.

[34] [1902] A.C. 83 (P.C.).

[35] *Ibid.* at 93.

[36] [1982] 1 W.L.R. 2 (Ch.D.).

[37] [1978] Ch. 406 (Ch.D.).

on those directors and majority shareholders themselves.[38]

The operative act for the managerial act to be termed as constituting a fraud on the corporation and the minority is the improper benefit conferred on the directors or the majority. The concept of "control" has also received judicial attention. The court will allow a minority's action to proceed where it recognizes that the person who has committed the wrong against the corporation and the minority is also in control of that corporation, as he is unlikely to permit proceedings to be initiated against himself. In the *Prudential Case,*[39] the court held that *control*:

> ...embraces a broad spectrum extending from an overall absolute majority of votes at one end, to a majority of votes at the other end made up of those likely to cast by the delinquent himself plus those voting with him as a result of influence or apathy.[40]

In the court of first instance Vinelott, J. was ready to extend the meaning of control to cover a situation where there is control in practice i.e. *de facto* control.[41] The existence of control may not be difficult to prove in a closely held corporation, but this may present some trouble of identification in large public corporations, as shares in such public corporations may be held by nominees and trustees making it difficult for the minority shareholder to prove control by the majority. Thus the courts are ever ready to find control where there is enough evidence to show circumstances that a person or group of persons exercise dominance and

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[38] *Ibid.* per Templemann, J. at 414.

[39] [1982] Ch. 204 (C.A.).

[40] *Ibid.* at 219.

[41] [1981] Ch. 257 (Ch. D.).

influence over the running of the corporation. In *Russell v. Wakefield Waterworks Co.*,[42] Jessel, M.R. held that:

> It is not necessary that the corporation should absolutely refuse by vote at the general meeting, if it can be shewn either that the wrong-doer had command of the majority of the votes, so that it would be absurd to call the meeting; or if it can be shewn that there has been a general meeting substantially approving of what has been done; or if it can be shewn from the acts of the corporation as a corporation, distinguished from the mere acts of the directors of it, that they have approved of what has been done, and have allowed a long time to elapse without interfering, so that they do not intend and are not willing to sue. In all those cases the same doctrine applies, and the individual corporator may maintain the suit.[43]

In *Omisade v. Akande,*[44] the Nigerian Supreme Court held that an action could be maintained by a party against another shareholder under the fraud against the minority exception even though the two shareholders in the corporation each equally held 50% of the shares.This was also the position in *Re Gandalman Investments Inc. and Fogle,*[45] where a 50% shareholder was allowed to sue derivatively as a complainant.

e. The Delayed General Meeting Exception

Section 300(e) CAMA adopts the principle laid down in *Hodgson v. National & Local Government Officers Association,*[46] establishing a member's right to come to court where a company meeting cannot be called in time to be of practical effect. This exception has been accepted in England though to a limited extent. It is universally recognized under the statutes that the calling of company's general meeting is within the powers of the directors as

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[42] (1875), L.R. 20 Eq. 474.

[43] *Ibid.* at 482.

[44] (1987), 2 N.W.L.R. 158 (Nig. S.C.), see especially Mohammed Bello, C.J.N. at 167-170.

[45] (1985) 22 D.L.R. (4th) 638 (Ont. H.C.).

[46] [1972] 1 W.L.R. 130.

provided for in section 127 of the ABCA and sections 211, 213 and 215 of the CAMA for example. Thus where the directors will not call the desired meetings, a minority shareholder could sue in respect of matters within the control of the majority, if in practical terms it were impossible for the majority to express their view before the matter became moot.[47]

f. The Improper Benefit And Profit Exception

Section 300(f) CAMA provides that the minority member can obtain a declaration or an injunction from the court where the directors have profited or benefited or are likely to profit or benefit from their negligence or breach of duty. In *Daniels v. Daniels,*[48] the directors of the corporation purported to sell a piece of company land to one of them at a price well below market value. The court granted an injunction to the minority challenging the sale.

g. The Interest of Justice Exception[49]

In *Foss v. Harbottle,* Wigram,V.C. had held that:

> ...the claims of justice would be found superior to any difficulties arising out of technical rules respecting the mode in which corporators are required to sue.[50]

It has been recognized that the rule of proper plaintiff will be relaxed when necessary in the interest of justice. In *Edokpolo & Co. Ltd. v. Sem-Edo Wire Industries Ltd.,*[51] the Nigerian Supreme Court allowed the minority to sue in the interest of justice where three

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[47] See Paul L. Davies, *supra* note 3 at 672.

[48] [1978] 2 All E.R. 89 (Ch. D.).

[49] Kaiser D. Barnes, "Justice Survives *Foss v. Harbottle* Rule in Nigeria" (1986) Nig. Current L. Rev. 175; See also R. Dick, "A Reconsideration of the 'Justice' Exception to the Rule in *Foss v. Harbottle*" (1966) 2 U. B. C. L. Rev. 457; O. A. Osunbor, "A Critical Appraisal of 'The Interests of Justice' as an Exception to The Rule in *Foss v. Harbottle*" (1987) Int. & Comp. L. Q. 1.

[50] (1843), 67 E.R. 189 at 203.

[51] (1984), 7 S.C. 119 (Nig. S.C.).

people had joined together to form a company in Nigeria and pursuant to a pre-incorporation agreement in which some shares were alloted to the appellant. After the incorporation, the appellant's shares were purportedly reissued to some key officers of the corporation in violation of the pre-incorporation agreement and to the detriment of the appellant who had done a lot of work and took great pains and trouble to facilitate the formation and registration of the corporation. According to Nnamani, J.S.C.:

> I cannot see any better case in which the interests of justice dictate that the appellant... should be allowed to sue.... In essence the appellant now alleges collusion between the the German Company, the second and third respondents, the result of which was the allotment to the second and third respondents of shares out of the 40% alloted to it.[52]

Also Aniagolu, J.S.C. noted that the appellant cannot be allowed to be "guillotined out of court and out of justice" under the rule in *Foss v. Harbottle*, and that:

> [T]his is a clear case in which a minority shareholder should in the interest of justice be allowed to sue as one of the exceptions to the rule in *Foss v. Harbottle*. Left unanswered, the impression....must be that the the plaintiff took all the trouble, time, finance, industry-to bring in a German company into Nigeria with which it incorporated as a Nigerian company only to be highjacked by the second and third respondents in collusion with the German company...that they have ganged up with the German company to cheat the plaintiff of his interest in a company which he, almost singlehandedly, has brought into being.[53]

However in England the interest of justice exception as recognized by Vinellot, J. in the court of first instance in *Prudential Assurance Co Ltd v. Newman Industries Ltd. (No 2),*[54] was dismissed as an invalid and impractical test by the Court of Appeal because the appellate judges were not convinced of its practicality. They stated: "we are not convinced that this is a practical test, particularly if it involves a full-dress trial before the test is applied....The

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[52] *Ibid.* per Nnamani, J.S.C. at 144.

[53] *Ibid.* per Aniagolu, J.S.C. at 123.

[54] [1981] Ch. 287 (Ch.D.).

rule.....is founded in principle, but it also operates fairly by preserving the rights of the majority."[55] Thus to some extent the exception is a dead letter in England. But Sealy has submitted that the wide meaning given to fraud in *Estimanco (Kilner House) Ltd. v. G.L.C.*,[56] has made the difference between interest of justice exception and fraud a matter of semantics.[57] To Gordon Phillips, no judge-made rule like the rule in *Foss v. Harbottle* will be applied when the result strikes the judges as unjust. This constitutes the basis for applying the justice test to the application of the rule in *Foss v. Harbottle.*[58] In *Elufioye v. Halilu,*[59] the Nigerian Court of Appeal held that an individual is permitted to bring an action even if it amounts to suing on a corporate right, as his right to come to court is also guaranteed under section 6(6)(b) of the Federal Republic of Nigeria Constitution falling under the citizen's fundamental rights.

IV. The American Approach

The American courts' approach is diametrically opposed to the English courts' approach. First, the American courts recognized that the minority stockholders are to be protected from absolute managerial powers of the board under the control of the majority shareholders. Second, they also recognized that in widely held corporations, the problem was not always between the majority and the minority, but that of the struggle between the

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[55] [1982] Ch. 204 at 224 (C.A.).

[56] [1982] 1 W.L.R. 2 (Ch. D.).

[57] See L.S. Sealy, "A Setback for the Minority Shareholder" (1982) Cam. L. J. 247.

[58] See Gordon Phillips, *Personal Remedies for Corporate Injuries*, (Scarborough: Carswell, 1992) at 336.

[59] (1990), 2 N.W.L.R. 1 (Nig. C.A.).

stockholders and the officers-managers, i.e. "managerialism." According to Riley,[60] "large corporations are frequently controlled not by their owners (the shareholders), but by their senior managers." The need to curtail the directors powers was underscored in *Dodge v. Ford Motor Co.*,[61] that:

> A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end in itself, to the reduction of profits, or to the nondistribution of profits among shareholders in order to devote them to other purposes.[62]

The foremost proponents of the need to protect the shareholders in widely owned corporations from the managers' abuse of their wide managerial powers were Adolph A. Berle, Jr. and Gardiner C. Means.[63] They identified that where the shareholders are so widely dispersed that there is no single shareholder holding sufficient bloc of shares to challenge the directors and officers, then it may be necessary to have sufficient provisions to guide the use of managerial powers. In such situations, where a separation had occured between the ownership and control of the corporation, co-ordinated action amongst the shareholders will likely not be feasible nor practicable, and those actually running the corporation will be the directors who sometimes misuse and abuse their corporate powers. In an earlier work, Berle[64] had opined that:

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[60] See Christopher Riley, "Understanding and Regulating the Corporations" (1995) 58 Mod. L. Rev. 595.

[61] 170 N.W. 668 (Mich. 1919).

[62] *Ibid.* at 684.

[63] See Adolph A. Berle,Jr., & Gardiner C. Means, *Corporations And Private Property*, rev. ed., (New York: Harcourt, Bruce and World, 1968).

[64] See A. A. Berle, Jr., "Corporate Powers As Powers In Trust" (1930-31) 44 Harv. L. Rev. 1049.

> ..all powers granted to a corporation or to the management of a corporation, or to any group within the corporation, whether derived from statute or charter or both, are necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interest appears.That, in consequence, the *use* of the power is subject to equitable limitation when the power has been exercised to the detriment of such interest....That many of the rules nominally regulating certain specific uses of corporate powers are only outgrowths of this fundamental equitable limitation, and are consequently subject to be modified, discarded, or strengthened, when necessary in order to achieve such benefit and protect such interest.[65]

In support of the position that managerial powers in widely owned corporations should be used for the benefit of the shareholders only, Milton Friedman had written that:

> In a free enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has (a) direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of society.[66]

The American courts had always been eager to protect the shareholders from the excesses of the managers. In *Channon v. Channon Co.*, [67] the court ordered a declaration of dividends that were being witheld by the directors. Similarly in *Anderson v. Dyer,*[68] touching on "freezing out," the court held that the witholding of the dividends was to depress the price of the corporation's shares so as to enable the directors and its allies to purchase the shares in the market at a lower price and thus was an abuse of corporate powers. Also in *Dodge v. Ford Motor Co.,*[69] the court held that the dividends were being unreasonably withheld by the directors from the shareholders. The above shows that the American courts, in the context

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[65] *Ibid.*

[66] See Milton Friedman, "The Social Responsibility of Business is to Increase Its Profits" in New York Times (Magazine), September 13, 1970, at 6 paras 32-33.

[67] 218 Ill. App. 397 (1920).

[68] 101 N.W. 1061(Minn. 1904).

[69] 170 N.W. 668 (Mich. 1919).

of derivative actions, were not only concerned with majority-minority relationships but were also ready to intervene where the directors and officers have accumulated enormous managerial powers. This is especially true in a widely owned corporation, where it is impossible for the shareholders to effectively deal with the managers. Thus Berle submitted that:

> ...corporation law is substantially at the stage in which equity was when it faced the situation of a trustee who had been granted apparently absolute powers in his deed of trust. So far as the law and the language went, the power was absolute; the trustee could do as he pleased; could perhaps trade with himself irrespective of his adverse interests; could, perhaps, sell the trust assets at an unfairly low price. Yet to permit untrammeled exercise of these powers would be to violate the whole underlying concept of the trust institution...Courts, accordingly, have been substantially forced to the conclusion here expressed: namely, that no power, however absolute in terms, is absolute in fact; that every power is subject to the essential equitable limitations. In this concept, corporation law becomes in substance a branch of the law of trusts.[70]

V. The Emergence of Statutory Procedural Rules for Enforcing Corporate Rights

The rule in *Foss v. Harbottle* had proved to be a restriction on the minority shareholder's right to enforce the company's rights. It also resulted in intricate, complex and uncertain rules which were not only obscure but similarly whimsical. Further the courts adopted inconsistent policies in dealing with minority actions. Lastly, the rule was extended beyond its proper scope. The effect of the above on Canadian corporation law was that after a discovery of lack of adequate protection for the minority shareholder at common law, the legislatures decided to adopt the American clear and workable derivative rules.[71] According to Bruce Welling:

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[70] See A.A. Berle, Jr., *supra* note 64 at 1073-1074. See also R. Fitch and M. Oppenheim, "Who Rules the Corporation" Pts I-IV. (1970) Socialist Vols. 4 & 5; Jerome Frank, "Some Realistic Reflections on Some Aspects of Corporate Reorganization" (1939) 19 Virginia L. Rev. 541.

[71] Originally contained in Equity Rule 94, now contained in Rule 23.1 of the United States of America *Federal Rule of Civil Procedure,* as amended (1993).

> ....Canadian legislatures have created some. They began about 1970, and much of their reform has been directed toward codifying in the statutes procedural remedies, designed to protect the individual shareholder from the twin oppressors of managerial power and majority rule.[72]

These statutory reforms neutralized the effect of the 1982 English Court of Appeal's decision in *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No2),*[73] which rejected the interest of justice as an exception to the rule in *Foss v. Harbottle* on the ground of doubtful practicality test. Commenting on this Gordon Phillips submitted that:

> ...made little stir in Canada, since the various legislatures had already intervened to replace the judge-made rules governing derivative actions with statutory rules. But it serves as a good reminder of the reasons why those legislatures were forced to intervene.[74]

But it was not only the Canadian legislatures that had to intervene by replacing the English corporation law with statutory rules. In 1988, the then Hon Minister of Justice and Attorney General of the Federation of Nigeria, Prince Bola Ajibola, SAN, K.B.E. appointed the Nigerian Law Reform Commission on the Reform of Nigerian Company Law (hereinafter "the Law Reform Commission"), which prepared the CAMA. It was recognized that in order to keep pace with the growing and tremendous industrial and commercial development engendered by the sudden oil boom wealth of 1970-80s, there had to be a reappraisal of the Nigerian corporation law which had become outdated.[75] Before we consider the Nigerian experience, we must look at the various stages of the Canadian reformation.

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[72] See Bruce Welling, *Corporate Law in Canada:The Governing Principles,* 2nd. ed., (Toronto: Butterworths, 1995) at 516; See also J. E. Smith, "The Canadian Business Corporations Act: What Effect May it Have on the Concentration of Economic Power" (1975-76) 1 Can. Bus. L. J. 448; B. Slutsky, "The Relationship Between the Board of Directors and the Shareholders in the General Meeting" (1968) 3 U. B. C. L. Rev. 3:81.

[73] [1982] Ch. 204 (C.A.).

[74] See Gordon Phillips, *supra* note 58 at 336.

[75] The Nigerian *Companies Act, Decree No. 51 (1968),* which was a reproduction of the *English Companies Act of 1948.*

The journey began in Ontario, the commercial and business capital of Canada, when a Select Committee of the Legislative Assembly was appointed in June 1965 (hereinafter "the Lawrence Committee"). The Select Committee submitted its report in 1967[76] (hereinafter "the Lawrence Report"), and this formed the basis of the Ontario *Business Corporations Act* of 1968, which in turn was revised and modified as Ontario *Business Corporations Act* of 1970 (hereinafter "the OBCA").[77] On this development, Bruce Welling commented that:

> The 1970s saw the most important and widespread wave of reform in Canadian corporate history. It all began when Ontario, Canada's most populous, most industrially and commercially active province completely reformed its corporate law. The ancient and out-moded letters patent was discarded. The English model, which was 125 years old by then, was rejected as being outdated as well. An entirely new type of corporate constitution was adopted, primarily drawn from the New York statute.[78]

This led to the reform of corporation laws in most Canadian Provinces.[79] Concerning the minority's right to the court, the Lawrence Report had rightly noted that:

> The Committee therefore recommends that the Ontario Act be amended by adding a substantive provision to the effect that a shareholder of a company may maintain an action in a representative capacity for himself and all other shareholders of the company suing for and on behalf of the company to enforce any rights, duties, or obligations owed to the company which could be enforced by the company itself or to obtain damages for any breach thereof. The Act should further be amended to set out the following procedural aspects of the substantive remedy....Further, the Act should provide that the intended plaintiff must make application *ex parte* to a judge of the High Court of Ontario designated by the Chief Justice of the High Court for an order permitting the plaintiff to commence the action. In practice, it can be assumed that the application will be supported by affidavit material which would include the draft writ of

[76] *Interim Report of the Select Committee on Company Law, (the Lawrence Report)* (Toronto: Ontario Queen's Printer, 1967).

[77] R.S.O. 1970, c. 53.

[78] Bruce Welling, *supra* note 72 at 47.

[79] See Ivan R. Feltham, Q.C. & William R. Rauenbusch, "Directors' and Officers' Liabilities in Canada" (1975-76) 1 Can. Bus. L. J. at 321-323.

summons and statement of claim.[80]

This recommendation was enacted as section 99 of the OBCA.[81] In July 1973, following the apparent success of the OBCA, and further to the work of the Task Force on Corporate Law (hereinafter "the Dickerson Committee"),[82] a report (hereinafter "the Dickerson Report")[83] was released which led to the 1975 enactment of the Canada *Business Corporations Act* (hereinafter "the CBCA").[84] Similarly in 1980, the Alberta Institute of Law Research and Reform's report[85] on the reform of corporation law led to the enactment of the Alberta *Business Corporations Act* ("ABCA").[86] Section 232 of the ABCA also contains identical provisions on the procedural rules governing the shareholder's derivative actions with the OBCA and the CBCA. Commenting on the wide reception accorded the reforms in Canada, Gordon Phillips rightly observed:

> By the time *Foss v. Harbottle* celebrated its 125th anniversary the rules surrounding derivative actions had grown intolerable, both in terms of their complexity and in terms of their perceived

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[80] *The Interim Report of the Select Committee on Company Law, (the Lawrence Report),* (Toronto: Ontario Queen's Printer, 1967) at 63.

[81] *Re Goldhar and Quebec Manitou Mines Ltd.* (1976), 61 D.L.R. (3d) 612 (Ont. Div.Ct.); *Farnham v. Fingold,* [1973] 2 O.R. 132, 33 D.L.R. (3d) 156 (Ont. C.A.); *rev'g* on other grounds [1972] 3 O.R. 688 (Ont. H. C.); *Goldex Mines Ltd. v. Revill*; *Probe Mines Ltd. v. Goldex Mines Ltd.*, [1973] 3 O.R. 869 (Ont. Div. Ct.); 1 O.R. 659; *aff'd* (1974), 7 O.R. (2d) 216 (Ont. C.A.); *Feld v. Glick* (1975), 8 O.R. (2d) 7 (Ont. H.C.).

[82] See R. W. V. Dickerson, J. L. Howard & L. Getz, *Proposals for a New Business Corporations Law for Canada (the Dickerson Report)* (Ottawa: Information Canada, 1971).

[83] *Proposals for a New Business Corporations Law for Canada (the Dickerson Report)* (Ottawa: Information Canada, 1971).

[84] The *Canada Business Corporations Act,* (the CBCA) R.S.C. 1974-75-76 (Can), c. 33. (Now amended as the *Canada Business Corporations Act,* R.S.C. 1985 c. C-44.)

[85] *Alberta Institute of Law Research and Reform (now Alberta Law Reform Commission)* 's *Proposals for a New Alberta Business Corporations Ac*t Vol. 1 (Edmonton: ILRR, 1980).

[86] *The Business Corporations Act,* S.A., 1981, c B-15.

> injustice. Ultimately the legislatures were forced to step in, and in most of Canada the common law rules have been largely superseded by statutory rules.[87]

Turning back to Nigeria, the Law Reform Commission recognized that:

> the protection of the minority has always been the concern of company law and lawyers....Questions have been asked as to how long the rule in *Foss v. Harbottle* will continue to be an obstacle to shareholders who feel they have good cause to complain about how the affairs of the company are being run.[88]

The Commission went on to note that:

> we have examined not only the existing statute law, but also relevant principles of common law and doctrines of equity... .[and] the company law of several countries e.g....Canada.[89]

After examining the state of the laws in many North American and Commonwealth countries, particularly the United States of America and Canada, on the subject of derivative actions, the Law Reform Commission deduced that:

> Derivative actions have been developed to a high degree in both the United States and Canada to ensure the enforcement of corporate rights not only within the exceptions to the rule in *Foss v. Harbottle* but also as a means of remedying wrongs done to the company which fall outside the scope of the exceptions. A complainant under the Canadian jurisdiction may apply for leave to bring an action on behalf of a company or any of its subsidiaries or to intervene in an action to which any body corporate is a party, for the purpose of prosecuting, defending or discontinuing the action on behalf of the body corporate.[90]

The result of this was the enactment of section 303 of the CAMA. However it must be noted at this stage that the Nigerian corporation law is a hybrid of the English contractarian model and the North American division of powers model, in that it makes provisions for the common law exceptions in section 300 (a) to (f) and at the same time

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[87] See Gordon Phillips, *supra* note 58 at 347.

[88] *Nigerian Law Reform Commission's Working Papers on the Reform of Nigerian Company Law,* (Review and Recommendations) Vol. 1 (Lagos: NRLC, 1988) at 232.

[89] *Ibid.* at 5.

[90] *Ibid.* at 238, paras 22 - 23.

recognizes the shareholder's statutory right to a derivative action separate from the common law judge-made rules. Thus Professor Oladeji Akanki suggested that:

> To tap the potential of this provision for redress of injury to the company minority we must start with the true meaning of the old law that was lost through premature definition and consider the new extention in the light of similar provisions elsewhere.[91]

He then showed where to look in interpreting the provisions of CAMA:

> In the interpretation of the new deal for company minorities in Nigeria, it is Canada, more than any where else, that Nigerian courts must look for comparisons and, or persuasive precedents. The two provisions are not only similar but also the most comprehensive. They are not circumscribed by the doctrine of non-interference. Besides, Canada has about fifteen years experience to borrow from.[92]

Following the above advice from Akanki, a comparative study of the derivative actions provisions in CAMA and ABCA against the background of American business corporations law will be carried out in the next chapters.

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[91] E.Oladeji Akanki, "Reformulating the Law Against Oppression in Companies" (1990/91) 13, 14 & 15 The Journal of Private & Property Law 19 at 28.

[92] *Ibid.* at 31.

CHAPTER 3

STATUTORY DERIVATIVE ACTIONS IN NIGERIA AND ALBERTA

Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honestly alone, but the punctilio of an honor the most sensitive,is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate.Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions....Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.

-Mr Justice Benjamin Cardozo
in *Meinhard v Salmon*, 164 N.E. 545 at 546 (N.Y.,1928).

I. Introduction

From the commencement of this thesis, the background events that led to the reformation of the statutory derivative actions in Nigeria and Canada have been examined. This chapter further considers in detail the statutory procedural requirements for instituting a derivative action under the CAMA and ABCA respectively.[1] It identifies the similarities and differences between the two statutes, and highlights and explains the policy considerations behind the two corporation statutes against the background of similar provisions in the United States of America business corporations laws. It also examines the various ways by which the North American courts have interpreted such provisions since their enactment towards these

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[1] See generally s. 239 of the CBCA, R.S.C. 1985, c. C-44; s. 246 of the OBCA, R.S.O. 1990, c. B.16; See also British Columbia *Business Corporations Act*, R.S.B.C. 1979, c. 59, s. 225 (hereinafter "the BCCA"). The OBCA and BCCA contain little differences in their provisions, but generally the statutory requirements are the same all over the Canadian Provinces. For the American provisions see Rule 23.1 U. S. *Federal Rules of Civil Procedure,* as amended (1993); Delaware *General Corporation Law,* Del. Code Ann. tit. 8 s. 327 (Supp. 1993); New York *Business Corporation Law* ss 626 & 627 (McKinney 1996); California *General Corporation Law,* s. 800 (West 1990). In particular see the critical evaluation of the shareholder derivative suit by M. Baxter, "The Derivative Action Under the Ontario Business Corporations Act: A Review of Section 97" (1982) 27 McGill L. J. 454.

cases serving as guidelines for the Nigerian courts when faced with similar situations in the future. Finally, it evaluates how far the statutory derivative actions have eased the problems facing the minority shareholder at common law since their coming into force in the 1970s. In trying to achieve the above objectives, the writer will undertake a brief historical investigation of the origin of derivative actions at the court of equity.[2]

II. The Background in Equity of Derivative Actions

Lord Atkin upholding the equitable maxim of *ubi jus ibi remedium*[3] in *United Australia Bank Ltd. v. Barclays Bank Ltd.*,[4] had emphasised the duty of Courts of Equity not to allow legal technicalities and traditions to prevent them from doing justice where legal injuries or wrongs occur. Lord Atkin had observed that:

[W]hen these ghosts of the past stand in the path of justice clanking their medieval chains, the

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[2] For a detailed history of the origin and nature of statutory derivative actions see Bert S. Prunty, Jr., "The Shareholders'Derivative Suit: Notes on its Derivation" (1957) 32 N. Y. U. L. Rev. 980; See also Paul L. Davies, ed., *Gower's Principles of Modern Company Law* , 6th ed., (London: Sweet & Maxwell, 1997) at 658- 678; Bruce Welling, *Corporate Law in Canada: The Governing Principles*, 2nd ed., (Toronto: Butterworths, 1991) at 509-547; *Pennington's Company Law*, 7th ed., (London: Butterworths, 1995) at 863-920; John Birds et.al., *Boyle & Birds' Company Law*, 3rd ed., (Bristol: Jordans, 1995) at 491-533; Gordon Phillips, *Personal Remedies For Corporate Injuries* (Scarborough: Carswell, 1992); Stanley M. Beck, "Shareholders' Derivative Action" (1974) 52 Can. Bar Rev. 159.

[3] This simply means "where there is an injury, there must be a remedy." Courts of equity will generally not allow a legal wrong to go without a remedy simply on the basis of technical legal rules. See also the opinion of Karibi - Whyte, J.S.C. in *Bello v. Attorney - General of Oyo State* (1986), 5 N.W.L.R. (Pt. 45) 828 at 877B (Nig. S.C.). This was what Adolph A. Berle, Jr. in "Corporate Powers As Powers In Trust" (1930-31) 44 Harv. L. Rev. 1049 at 1073-1074, observed that: "......corporation law is substantially at the stage in which equity was when it faced the situation of a trustee who had been granted apparently absolute powers in his deed of trust. So far as the law and the language went, the power was absolute; the trustee could do as he pleased; could trade with himself irrespective of his adverse interests; could perhaps, sell the trust assets at an unfairly low price. Yet to permit untrammeled exercise of these powers would be to violate the whole underlying concept of the trust institution.....Courts, accordingly, have been substantially forced to the conclusion here expressed: namely, that no power, however absolute in terms, is absolute in fact; that every power is subject to the essential equitable limitations. In the concept, corporation law becomes in substance a branch of the law of trusts."

[4] (1941), A.C. 1 (H.L.).

proper cause for a judge is to pass through them undeterred.[5]

However it was not only the courts that thought it very paramount to take bold steps towards in enthroning justice, fairness and equity. As we have seen previously, the Canadian and Nigerian legislatures did likewise by easing the minority shareholders access to the courts. In this connectios, Stanley Nemser[6] had observed that equity devised the shareholder's derivative suit to avoid frustration of justice in that at common law a shareholder could not call directors to account for misconduct in their management capacities in an action at law.[7] In the same vein, Martel and Sink viewed the minority shareholder's derivative action as a suit in equity by a shareholder to enforce a corporate right[8] or claim similar to a stockholder intervention in a pending suit brought by or against a corporation.[9] To this end, Nemser thus defined it as a suit:

> brought by the shareholder as plaintiff in the right of the corporation against directors and/or third parties, in those circumstances in which the directors have improperly refused to authorize the corporation to sue or the directors are incapable of representing the interests of the corporation in the litigation, such as personal involvement in the wrongs complained of....Any

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[5] *Ibid.* per Lord Atkin at 29.

[6] See Stanley Nemser, "Derivative Actions" in Stuart D. Weschler, ed., *New Directions in Securities Litigation* (New York: Practising Law Institute, 1976) 69.

[7] *Ross v. Bernard*, 396 U.S. 531 (1969); 90 S.Ct. 733 (1970).

[8] John S. Martel & Charles M. Sink, "The Derivative Action: Is There Life After Lasker?" in J.S. Martel, ed., *The Investor and the Corporation New Developments and Tactics in Stockholder Litigation* (New York: Practising Law Institute, 1980) at 201; also Ernest L. Folk, III, in *The Delaware General Corporation Law* (Boston: Little, Brown & Co., 1972) at 484, noted that: "..A derivative action has a dual nature. First, 'it asserts as the principal cause of action a claim belonging to the corporation.' Second, since the corporation refuses to sue, the complainant stockholders 'have a right in equity to compel the assertion of the corporation's rights to redress."

[9] *Thorman v. Dome Producing & Dev. Co.*, 50 Cal. App. (2d) 201 (1942).

recovery belongs to the corporation.[10]

The concept of the minority shareholder's "derivative action" has its earliest origin, based on the equitable concepts of trust and accountability, in the United States of America. It was first recognized by Chancellor Kent in 1817 in *Attorney General v. Utica Ins.Co.,*[11] and it was applied as a basis for a shareholder action for the first time in 1832 in *Robinson v. Smith.*[12]

In *Robinson v. Smith,* the minority shareholders of a coal corporation sued the directors for fraudulent misapplication of corporate funds through unwarranted investment in some banks. The court of equity held that this was an apparent abuse of managerial power which was incompatible with the relationship between the directors and the shareholders based on trust, and in effect the exercise of managerial powers was subject to substantive

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[10] See Stanley Nemser, *supra* note 6 at 69; Further according to Lord Denning, M.R. in *Wallersteiner v. Moir* (No. 2), [1975] 1 All E.R. 849 at 857- 858 (C.A.), "The rule is easy enough to apply when the company is defrauded by outsiders. The company itself is the only person who can sue. Likewise, when it is defrauded by insiders of a minor kind, once again the company is the only person who can sue. But suppose it is defrauded by insiders who control its affairs-by directors who hold a majority of the shares-who then can sue for damages? Those directors are themselves the wrongdoers. If a board meeting is held, they will not authorise proceedings to be taken by the company against themselves. If a general meeting is called, they will vote down any suggestion that the company should sue them themslves. Yet the company is the one person who is damnified. It is the one person who should sue. In one way or another some means must be found for the company to sue. Otherwise the law will fail in its purpose. Injustice will be without redress...To avoid this circuity,....the minority shareholders themselves could bring an action in their own names(but in truth on behalf of the company) against the wrongdoing directors for the damage done by them to the company...."

[11] See Chancellor Kent in *Attorney General v. Utica Ins. Co.,* 2 Johns. Ch. *371 at *389-90 (N.Y. 1817) where he held that " But, at the same time, I admit, that the persons who, from time to time, exercise the corporate powers, may, in their character of trustees, be accountable to this court for a fraudulent breach of trust; and to this plain and ordinary head of equity, the jurisdiction of this court over corporations ought to be confined.....Nor does the case, as charged, amount to a breach of trust, of which I am to take notice. There is no complaint, on the part of the stockholders, of misconduct, nor is the information founded on any thing of that kind. If there had been a prosecution instituted for a breach of trust, it would have been by bill, and against individuals by name, calling them to account for the use and benefit of the company at large."

[12] See 3 Paige Ch. *222 (N.Y. 1832). In the earlier cases of *Ogden v. Kip,* 6 Johns. Ch. *18 (N.Y. 1814) and *Verplanck v. Mercantile Ins. Co.*, 2 Paige *438 (N.Y. 1831), the court of equity had shown its readiness to intervene in corporate disputes and assume jurisdiction to set aside abuse of corporate powers by the directors.

equitable rules.[13] The doctrine of derivative action further grew in stature in *Taylor v. Miami Exporting Co.*,[14] and in many court of equity decisions over the years. [15] At common law, its mode, operation, acceptance and existence was uncertain until it was formally recognized as applicable under English common law by Lord Denning, M.R. when he used the American term "derivative action" in *Wallersteiner v. Moir (No.2)*.[16] In Nigeria, the minority shareholder's action based on the concepts of trust, agency and equity, which was originally a common law legacy is now part and parcel of the Nigerian corporation law even before the CAMA amendments, as the Nigerian Supreme Court noted in *Omisade v. Akande*[17] that:

> I agree...that a minority shareholder's action or derivative action is a procedural device by means of which on the principle of equity a relief, such as restitution of unjust enrichment by its director, is sought on behalf of a company... However, the substantive aspect of the minority shareholder's action is an action for restitution based on the principle of equity which prohibits a trustee from making profit by his management either directly or indirectly. The principle extends to all fiduciaries who in breach of their fiduciary duties, to their beneficiaries unjustly enriched themslves.[18]

In America, the shareholder's derivative suit was originally based on breach of trust,

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[13] Bert S. Prunty, Jr., "The Shareholders' Derivative Suit: Notes on its Derivation" (1957) 32 N. Y. U. L. Rev. 980.

[14] See 5 Ohio 162 (1831). Here the court relied heavily on the dicta of Chancellor Kent in *Attorney General v . Utica Ins. Co., supra* note 9 and so held that the directors are liable to return the corporation's property on the grounds of breach of fiduciary duty and trust position.

[15] See *Putnam v. Sweet,* 1 Chand. 286, (Wis. 1849); *Cunningham v. Pell,* 5 Paige Ch. *607 (N.Y. 1836); *Wells v. Jewett*, 11 How. Prac. 242 (N.Y. Sup. Ct. 1855); *Forbes v. Whitlock,* 3 Ed. Ch. 446 (N.Y. 1841); *Dodge v. Woosley,* 59 U.S. (18 How.) 331 (1855); *Vanderbilt v. Garrison,* 12 N.Y. Super. Ct. (5 Duer) 689 (1856); *Hawes v. Oakland,*104 U.S. 450 (1881).

[16] See Lord Denning, M.R. [1975] 1 All E.R. 849 at 858 (C.A.), adopting the minority shareholder derivative right principle as proposed by Professor L. C. B. Gower in *Principles of Modern Company Law*, 3rd ed., (London: Sweet & Maxwell, 1969) at 587.

[17] (1987), 2 N.W.L.R. 158. (Nig. S.C.). This was a judgement of the Nigerian Supreme Court which was delivered just before the CAMA came into effect in Nigeria.

[18] *Ibid.* per Mohammed Bello, C.J.N. at 168-169, (Nig. S.C.).

and so there were some steps to be taken by the minority shareholder before the court will permit him to sue derivatively. These procedural requirements originally set out in *Hawes v. Oakland,*[19] were subsequently embodied in U.S. Equity Rule 94.[20] They are now contained in Rule 23.1of the United States of America *Federal Rules of Civil Procedure* [21] as follows: (a) the action be one that could be properly asserted by the corporation; (b) the complaint shall be verified; (c) the defendant was a shareholder at the time of the wrong or that he became one after the wrong by the operation of law; (d) the jurisdiction has not been conferred collusively; (e) the efforts, if any, to obtain action by the board of directors; (f) the efforts to obtain shareholder action, if necessary; (g) the reason the shareholder failed to request director or shareholder action or why the action was not taken; (h) the shareholder must adequately and fairly represent the interests of the shareholders; and (i) the action shall not be dismissed or compromised without court approval and notice to other shareholders.[22]

III. The Statutory Derivative Provisions under the ABCA and CAMA

a. Alberta

The ABCA provisions on the minority shareholder's statutory derivative actions are

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[19] Per Justice Miller in 104 U.S. 450 at 451-462 (1881).

[20] 104 U.S.' IX (1882).

[21] As amended, (1993). These rules were originally set out in *Hawes v. Oakland,*104 U. S. 450 at 460-461. (1882); later on incorporated into Equity Rule 94, 104 U. S. IX (1882).

[22] See also Delaware *General Corporation Law,* Del. Code Ann. tit. 8 s. 327 (Supp. 1993); New York *Business Corporation Law,* ss 626 & 627 (McKinney 1996); California *General Corporation Law,* s. 800 (West 1990); s. 303 CAMA; ABCA s. 232; CBCA s. 239; OBCA s. 246; BCCA s. 225; *Wallersteiner v. Moir* (No. 2), [1975] 1 All E.R. 849 (C.A.).

parallel to and are now reproduced in Part A of the attached Apppendixes.[23]

b. Nigeria

The CAMA derivative actions are similar to the ABCA and these are reproduced in Part B of the attached Appendixes.

IV. The Company

The first identifiable difference between the provisions of the CAMA and ABCA is the fact that section 232 of the ABCA broadly allows the minority shareholder to institute a derivative action not only in matters concerning the affairs of the corporation, but covers wrongful acts in the corporation's subsidiaries and affiliated companies as well. Whereas on the other extreme, section 303 of the CAMA only allows an action where the acts occur directly in the corporation of which the shareholder is a member.[24] The provisions of the CAMA and BCCA respectively, allowing for the enforcement of a corporate right or breach of the directors duties and obligations via a minority shareholder suit only where it occurs in

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[23] The ABCA provisions represent most Canadian jurisdictions derivative action laws. Except for Nova Scotia and British Columbia which use the contractarian models and Prince Edward Islands (using the Letters Patent).

[24] This provision in CAMA s. 303 is similar to s. 225 of the BCCA, which provides:

(1) A member or director of a company may, with leave of the court, bring an action in the name and on behalf of the company

(a) to enforce a right, duty or obligation owed to the company that could be enforced by the company itself; or

(b) to obtain damages for any breach of a right, duty or obligation referred to in the paragraph (a).

(2) A member or director of a company, may with leave of the court, in the name and on behalf of the company, defend an action brought against the company.

According to Stein Gudmundseth & Sandra Draibye, "Derivative Actions" in Gordon Phillips, ed., *Remedies for Corporate Injuries* (Vancouver: The Continuing Legal Education, 1993) at 3.1.02: "The scope of the Derivative action provided under the CBCA (including ABCA) is somewhat wider than that provided under s. 225 of the BCCA. Under s. 239 of the CBCA a complainant may apply to court for leave to initiate, defend or discontinue an action on behalf of a corporation or any of its subsidiaries.There is no mechanism to bring a derivative action on behalf of a subsidiary under the BCCA."

the corporation of which he is a shareholder, appear to be aimed at avoiding the need for a separate hearing to determine the grounds upon which the court will permit an action by a shareholder of a parent company or an affiliated corporation based on a wrong occuring in the subsidiary corporation or in the affiliated corporation but not affecting his own interest in his company directly.[25]

The ABCA provisions are a product of the American concepts of *double derivative* and *triple derivative suits.*[26] In America, [27] the shareholder of a parent company may sue derivatively to enforce a claim on behalf of its subsidiary[28] (double derivative suit) or on behalf of its second-tier subsdiary (triple derivative suit).[29] For instance in *Martin v. D. B. Martin Co.,*[30] the court pierced the "corporation's corporate veil" and permitted a double derivative suit by a shareholder of the subsidiary company to enforce a corporate right in the parent company.[31] Similarly in *Brown v. Tenney*,[32] the Illinois Appellate Court upheld the principle of double derivative suit based on three theories. First was that current complexities of corporate law necessitate such, and with the emergence of conglomerates it will be absurd

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[25] These are referred to in America as *double derivative* and *triple derivative* actions, a position adopted under the ABCA but not under the CAMA.

[26] See Stanley Nemser, *supra* note 6 at 73 para (f).

[27] See Notes: "Suits by Shareholders in a Parent Corporation to Redress Injuries to the Subsidiary" (1951) 64 Harv. L. Rev. 1313.

[28] *Goldstein v. Grosbeck*, 142 F.2d 422 (2d Cir. 1944).

[29] *Upson v. Otis*, 155 F.2d 606 (U.S.C.A. 2d Cir. 1946).

[30] 88 A.612 (Del. Ch. 1913).

[31] See generally David Locascio, "The Dilemma of the Double Derivative Suit" (1989) 83 Nw. U. L. Rev. 729.

[32] 508 N.E.2d 347 (Ill. App. 1987), *aff'd* 532 N.E.2d 230 (1988).

to continue to adhere strictly to direct injuries. Second was that there is no rational theory barring it. Third was that theories denying double derivative suits failed to comport with the changing corporate world in modern society and the realities of the changing techniques and structures of the modern corporation.[33]

Analysing the decision in *Brown v. Tenney,*[34] David Locascio has further identified and propounded six main cogent reasons on which the double derivative suit principles are based,[35] and in this regard he notes that:

(1). A double derivative action is equivalent to a single derivative suit after the court has pierced the corporate veil and treated the parent and subsidiary as one corporation;

(2). A double derivative suit is justified because both the parent and the subsidiary are controlled by the same persons. Therefore, the shareholders of the parent are the only parties who might realistically bring a suit to redress a wrong to a subsidiary;

(3). A double derivative suit is in essence a suit by the beneficiary of a fiduciary (the parent company), which is in turn the beneficiary of a second fiduciary (the subsidiary company);

(4). A double derivative action is justified by agency principles, and so the parent company through its shareholder is the subsidiary company's agent;

(5). A parent corporation owes a duty to its shareholders to use its control of the subsidiary to right any wrong to it, and the shareholders may seek specific performance of that duty; and

(6). A double derivative action is justified because harm to the subsidiary will inevitably fall

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[33] *Ibid.* 508 N.E.2d 347 at 350 (Ill. App. 1987).

[34] *Ibid.*

[35] See David Locascio, *supra* note 31 at 734-735.

on the shareholders of the parent corporation.

Traditionally, there are two main policies that guide the court in allowing double derivative suits. First, there is a unity of interest and ownership that the corporation and its owners cannot be regarded as separate personalities. And second, continued separate corporate existence would perpetuate a fraud or injustice which the court could prevent.[36]

Under the ABCA,[37] a *subsidiary* is another corporation controlled by the parent corporation in the sense that the parent corporation has sufficient legal or equitable beneficial ownership in its securities to the extent that the parent corporation can singly elect the majority of the subsidiary's board of directors.[38] An *affiliate* corporation [39] is one that shares the same parent corporation with, or is the parent, or parent of the parent corporation of the corporation in which the legal injury has occurred. The rationale for allowing the shareholders of subsidiaries and affiliates to sue derivatively is that legal injury harming the subsidiary will indirectly harm the parent corporation's interest, and, as well, "there may be an occasional case in which it is necessary for the court in the interests of justice to go into the whole of an

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[36] *Schreiber v. Carney,* 447 A.2d 17 (Del. Ch. 1982).

[37] See ABCA s. 2 (2) & (4). For a full reproduction of these provisions, see Part A of the Appendixes to these research paper.

[38] According to Gordon Phillips, *Personal Remedies For Corporate Injuries* (Scarborough: Carswell, 1992) at 374-375, "The word "entitle" seems to mean that the first company could elect the majority even if every other shareholder of the subsidiary voted for a different slate, which in normal circumsstances could only be the case if the first company owned 50% of the subsidiary's shares.....American courts have long recognized the right of a shareholder in a "parent corporation" to bring an action for an injury to a "subsidiary", labelled a" double derivative suit." The economic rationale for recognizing such a right is not in dispute: Since every injury to a company is (indirectly) an injury to its shareholders, the injury to the subsidiary is an injury (albeit indirectly) to the parent and hence an injury (albeit indirectly again, in fact doubly indirectly) to the latter's shareholders."

[39] See ABCA s. 2(1) (a) & (b).

inter-related business."[40] in a related fashion, the Dickerson Committee had submitted that:

> By including the reference to a subsidiary of the corporation, this provision contemplates and permits the 'double derivative' action, that is, it confers on a shareholder of a holding corporation the right to initiate a derivative action in the name of a subsidiary of that holding corporation notwithstanding that the shareholder does not own a share of the subsidiary.[41]

Gordon Phillips has observed that shareholders in a company who wish to prosecute double derivative actions would have to show that the connection between the corporations is, in their particular case, such that success in the derivative action will ultimately, although indirectly, benefit the corporation of which they are shareholders.[42]

In *Ginther v. Rainbow Management Ltd.*,[43] a *sufficient connection* test for justifying double derivative suit was proposed. There Ginther was a shareholder holding 33% of shares in Rainbow Management which in turn held 33% of the outstanding shares in another corporation, i.e. Jafran Enterprises Ltd. Ginther had sought leave to bring a derivative suit against the directors of Jafran Enterprises Ltd. The Supreme Court of British Columbia, applying the test of *financial interest* laid down in *Re Daon Development Corporation*,[44] held that although Ginther did not technically have a *direct financial interest* in Jafran, there

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[40] *Alberta Institute of Law Research and Reform (now Alberta Law Reform Commission) Proposals for a New Alberta Business Corporations Act*, Vol. 1 (Edmonton: ILRR, 1980) at 148.

[41] *Proposals for a New Business Corporations Law for Canada,(the Dickerson Report)* Vol. 1 (Ottawa: Information Canada, 1971) at para. 481.

[42] See Gordon Phillips, *supra* note 38 at 378.

[43] (1989), unreported (B.C.S.C.) of April 12, 1989, No. A890240, Vancouver Registry; affirmed and leave to appeal refused by the B.C.C.A, (1989) unreported, (B.C.C.A.) Chambers, of July 24, 1989, No. CA010720, Vancouver Registry.

[44] (1984), 54 B.C.L.R. 235 (S.C.). Here Wallace, J. at 243, held that a proper person under s. 225(8) BCCA: "must have a direct financial interest in how the company is being managed...somewhat analogous to minority shareholders-where they have no legal right to influence or change what they see to be abuses of management or conduct contrary to the company's interest."

was *sufficient connection* between the Ginther and Jafran to warrant the exercise of discretion in deciding that the applicant was a proper person to institute the derivative suit. Accordingly the court held that the complainant had demonstrated sufficient financial connection with the corporation. In the words of Cowan, J:

> While the holding company Rainbow is interposed, as it were, between the petitioner and the operating company Jafran, so that the petitioner does not have a "direct financial interest" in that sense, nevertheless in my view, there is a sufficient connection between the petitioner and Jafran to warrant my exercising my discretion to decide that the petitioner is a proper person to bring the application. I do not consider that the fact that the financial benefits arising from Jafran's operations flow to the petitioner through the holding company Rainbow should disqualify him from seeking to obtain the remedies available ....[45]

From the above analysis, the provisions of CAMA will appear to be unduly restrictive by not allowing shareholders of subsidiaries and affiliates to sue, in that there are clear situations that the court can find that an injury to the subsidiary company will substantially affect the interests of the shareholders of the parent corporation. Secondly, it may be the case that there is sufficient connection between the two corporations to allow the minority's action as shown in *Ginther v. Rainbow Management Ltd.*[46] Perhaps the most compelling justification for double derivative action is the fiduciary theory stated by David Locascio:[47]

> Some courts have viewed the relationship between a corporation and its shareholders in a single derivative action as one between a fiduciary and a beneficiary. In a double derivative suit, two such relationships exist: One between the parent corporation and the subsidiary, and another between the parent and its shareholders. In the first relationship, the parent is a beneficiary; in the second, the parent is the fiduciary and its shareholders are the beneficiaries. According to the theory, the parent owes its shareholders a fiduciary duty, and similarly the subsidiary owes the parent a fiduciary duty. In a double derivative suit, the parents' shareholders sue to enforce

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[45] See Cowan, J. at 6 of the April 12, 1989 Reasons for Judgement.

[46] *Supra* note 43.

[47] David Locascio, *supra* note 31 at 751-752.

a right arising from the subsidiary's duty as a fiduciary to the parent, its beneficiary.[48]

V. The Requirement of Leave

In America, a derivative action is personal to the shareholder, but under the CAMA and ABCA the applicant has to obtain leave of the court before commencing a derivative action.[49] This judicial discretion granted to the courts to decide whether to permit the action to proceed is very wide and is to be used in doing justice on the peculiar facts of each case. Thus it has been described as:

> ...whimsical or as individually tailored to fit the exigencies of the situation, depending upon one's degree of adherence to the philosophy of non-intervention in the internal affairs of corporations....A statutory grant of discretion permits a judge to reach his decision unhampered by ironclad legal rules. He is expected to make use of wisdom, though not necessarily of legal principles.[50]

The reason for requiring the court's approval or leave before commencing a derivative action is to minimize and eliminate the danger of harassment of the board, strike suits, and to ensure that derivative actions are not used as a means of extorting money from the directors, or of blackmailing the majority. However, it is not to shut out legitimate shareholders claims, as O'Leary, J. held in *Re Marc-Jay Investments Inc. and Levy,*[51] that:

> It is obvious that a judge hearing an application for leave to commence an action, cannot try the action. I believe it is my function to deny the application if it appears that the intended action is frivolous or vexatious or is bound to be unsucessful. Where the applicant is acting in good faith and otherwise has the status to commence the action, and where the intended action does not appear frivolous or vexatious and could reasonably succeed; and where such action is in the

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[48] *Ibid.*

[49] See CAMA s. 303 (1) & ABCA s. 232 (1).

[50] See B. Welling, W.B. Rayner, C. Jordan & L.D. Smith et.al., eds., *Canadian Corporate Law: Cases, Notes and Materials* (Toronto: Butterworths, 1996) at 358; See also Ivor R. Feltham, Q.C. & William R. Rauenbusch, "Directors' and Officers' Liabilities in Canada" (1975-76) 1 Can. Bus. L. J. 321 at 334.

[51] (1974), 50 D.L.R. (3d) 45 (H.C.J.).

interest of the shareholders, then leave to bring the action should be given.[52]

The above shows clearly that the statutes require leave to be obtained by the minority before commencing a derivative action under CAMA and ABCA in order to weed out frivolous, vexatious or *mala fide* claims from the court, and that the courts will always permit the action where the facts of the case so require.

VI. The Categories of Persons, i. e. Complainant or Applicant[53]

Both the CAMA and the ABCA identify broad classes of persons within the corporate set-up who may commence derivative actions. Section 309 of the CAMA defines an "applicant," while section 231(b) of the ABCA defines a "complainant" for this purpose. The persons so statutorily specified are the present and past registered holders (legal) or beneficial owners (equitable) of the corporation's securities, present and past directors or officers, any other person who in the opinion of the court is a "proper person," and the Corporate Affairs Commission[54] (under CAMA). The courts have evolved various imterpretations for the identification of persons who may fall into the above categories as complainants.

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[52] *Ibid.* per O'Leary, J. at 47.

[53] The words "complainant" and "applicant" as used in the ABCA and CAMA respectively will be used interchangeably throughout this paper, and it will refer to the person that the court has permitted to initiate and prosecute a derivative action on behalf of the corporation.

[54] While the ABCA makes no provision for the Director, s. 238(c) of the BCCA provides for the Director to commence a derivative action. According to the *Dickerson Report op. cit.* footnote 41 Vol. 1, para 13: "the [Director's] function, for the most part, is to ensure that the law has been observed. Where an adjudication on conflicting rights is required, the adjudication should be made by a court, not a government official." In the same line, Professor O.A. Osunbor, in "The Enforcement of Directors' Duties-New Dimensions in the Companies and Allied Matters Decree 1990" (Paper Presented at a Workshop, "Issues of Corporate Management and Finance in the Companies and Allied Matters Decree 1990, held at Obafemi Awolowo University, Ile-Ife, Nigeria, on March 19-21, 1991.) (Unpublished) at 3 that, "The CAMD has made new provisions and strengthened existing regulations for overcoming impediments which hinder enforcement by the members through legal action and has fortified the Corporate Affairs Commission in its rule of intervening to enforce a director's duty to his company."

Under American and Canadian corporations law, the need to prevent strike suits, contemporaneous ownership rule, creditors status, and the persons falling within the residual category of *proper persons* in the opinion of the court, have generated heated legal debate over the years.

a. Present and Past (Registered Holder or Beneficial Owner) of the Corporation's Securities

The present and past registered/record (legal) holders or beneficial (equitable) owners of the corporation's securities can commence derivative actions in court.[55] Securities have been defined to include shares of any class or series of shares, debentures, debenture stock, bonds, debt obligation, a certificate evidencing such share or debt obligation, notes and units under a unit trust scheme.[56]

i. Current Shareholders

Both the CAMA and ABCA allow the present shareholders to commence derivative actions. It is appropriate that present shareholders be allowed to sue, since they are the primary beneficiaries of the derivative action provisions. Under the CAMA, ABCA and the common law, a person need not be a minority before he can be allowed to sue; all that is necessary is that he be a shareholder, thus in *Omisade v. Akande,*[57] the Nigerian Supreme

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[55] Under the ABCA, such persons can commence derivative actions on behalf and in the name of subsidiaries and affiliated corporations. See Section IV of this chapter above.

[56] See CAMA s. 650(1) & ABCA s. 1(u); see also section 1(v) of the *Alberta Securities Act,* S. A., 1981, c. S-6.1 which contains identical provisions for defining securities.

[57] (1987), 2 N.W.L.R. 158 (Nig. S.C.); see also *Re Gandalaman Investments Inc. and Fogle* (1985), 22 D.L.R. (4th) 638 (Ont. H.C.); *Liu v. Sung* (1988), 39 B.L.R. 236 (B.C.S.C.) *rev'd* (1991), B.C.L.R. (2d) 299 (C.A.); *Credit Foncier Franco-Canadien v. C. S. W. Enterprises Ltd.* (1986), 54 Sask. R. 97 (Sask. Q. B.) where a 50% shareholder was allowed to sue derivatively. Similarly in *Gillespie v. Overs* (August 14, 1987), Doc. RE 1088/87, RE 1115/87 (Ont. H.C.) a majority shareholder was held to be a complainant. A 55% shareholder was held to be a complainant in *Cairney v. Golden Key Holdings Ltd. (No. 1)* (1987), 40 B. L. R.

Court allowed an action where the two shareholders in the corporation each held 50% shareholding. In this connection, however, in America as well as in British Columbia, there is in operation the "contemporaneous ownership rule"[58] and the "continuing wrong" exception.[59]

Generally in America, the shareholder is expected to be a shareholder at the time of the wrong, commencement of the action and throughout the suit. According to Stanley Nemser:[60]

> ...it is required in a derivative suit that the shareholder plaintiff was a shareholder at the time of the transaction complained of, or that his stock devolved on him by operation of law. This 'time' requirement has been established either in....*Hawes v. Oakland*[61] and it is now contained in clause 1 of Rule 23.1, FRCP[62]....The shareholder in a derivative suit must not only meet the 'time' requirement, but he must also be a shareholder at the time the suit is brought,[63] and must

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263 (B.C.S.C.); Also in *Chrysler Canada Ltd. v. Shury* (April 12, 1988), Doc. Vancouver C850504 (B.C.S.C.) *aff'd* (June 5, 1989), Doc. CA009426 (B.C.C.A.) a 99% holder of issued common and preference shares was granted leave.

[58] See s. 225(3) (d)of the BCCA which provides that: "......in the case of an application by a member, he was a member of the company at the time of the transaction or other event giving rise to the cause of action....." Section 327 of the Delaware *General Corporation Law,* Del. Code Ann. tit. 8 (Supp. 1993) provides that: "in any derivative suit instituted by a stockholder of a corporation, it shall be averred in the complaint that the plaintiff was a stockholder of the corporation at the time of the transaction of which he complains or that his stock thereafter devolved upon him by operation of law." See generally *Hawes v. City of Oakland,* 104 U. S. 450 (1881); *Metal Tech Coproration v. Metal Teckniques Co.,*703 P.2d 237 (Or. App. 1985); *Computre Maintainance Corp. v. Tilley,* 322 S.E. 2d 533 (Ga. C.A. 1984).

[59] Robert Clark, *Corporate Law,* (Boston: Little, Brown & Co., 1986) at 651.

[60] See Stanley Nemser, *supra* note 6 at 70-72.

[61] 104 U.S. 450 (1881).

[62] See also similar provisions in Delaware *General Corporation Law,* Del. Code Ann. tit. 8 s. 327 (Supp. 1993); New York *Business Corporation Law,* s. 626 (McKinney 1996); California *General Corporation Law,* s. 834 (a) (1) (West 1990); Illinois *Business Corporation Act,* Ill. Ann. Stat. ch. 32 s. 45a (Smith-Hurd 1992).

[63] *deHaas v. Empire Petroleum Co.,* 435 F.2d 1223 (10th Cir. 1970); *Werfel v. Kramarsky,* 61 F.R.D. 674 (S.D.N.Y. 1974).

continue to be such during the pendency of the suit.[64] Where a shareholder disposes of his stock during pendency of derivative action, proper procedure may require dismissal without prejudice or notice to the shareholders with the right to intervene and take on prosecution of the litigation.[65]

The requirement that the shareholder's ownership of the shares must last till the end of the suit is very strict. Thus in *Sorin v. Shahmoon Industries, Inc.*,[66] the court noted that the plaintiff must be a shareholder at the time of the wrongful conduct alleged, at the time of commencing of the action, at the time of the trial, and at the time of entering the judgement.

This requirement may also be satisfied by the continuing wrong rule which, according to Alvin Stein,[67] allows shareholders to initiate a derivative action on a series of wrongful transactions alleged which constitute a single, continuing wrong, even if the initial act in the series of acts occured before they obtained their shares.

According to Gordon Phillips, the contemporaneous ownership requirement has served three purposes in America. First it prevents persons who want their cases to be heard in the federal courts from having an accomplice who resides in some particular juridiction tobuy shares in the company, and then commence a derivative action over which the federal courts would have jurisdiction by virtue of the diversity of the parties' residences and by this

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[64] *Orenstein v. Compusamp Inc.*, 19 F.R. Serv.2d 466 (S.D.N.Y. 1974).

[65] *Beaver Associates v. Cannon*, 59 F.R.D. 508 (S.D.N.Y. 1973); *Tryforos v. Icarian Development Co.*, 518 F.2d 258 (7th Cir. 1975); *Glechier v. Times-Columbia Distributors Inc.*, 283 App. Div. 709. (Ist Dept. 1954).

[66] 220 N.Y.S.2d 760 (N.Y. Sup. Ct. 1961).

[67] See Alvin M Stein, "Minority Shareholders in Publicly Held Corporations" in J.S. Martel, ed., *The Investor and the Corporation New Developments and Tactics in Stockholder Litigation* (New York: Practising Law Institute, 1980) 9 at 32, According to Gordon Phillips, *op cit* note 38 at 365, "American courts have developed a 'continuing wrong' doctrine, by which shareholders can sometimes satisfy (or, some might say, circumvent) the contemporaneous ownership requirement by arguing that even though the defendants' wrongdoing began before they bought their shares."

satisfying the 'diversity jurisdiction' requirement of the American federal court system.[68]

The second reason has been to prevent *strike suits* by which professional litigants would buy shares in companies simply to have standing to bring vexatious actions, which they would be prepared to settle if significant sums were paid to them personally.

The third rationale for the justification of contemporaneous ownership rule is that it serves a moral purpose:

> As a matter of policy one who buys shares with knowledge of a purported wrongdoing should not be permitted to bring suit to challenge that wrongdoing.[69]

Contrarily, to this writer the above justifications are not absolutely valid as the contemporaneous ownership requirement is of little relevance or significance in Canada and definitely not applicable in Nigeria. For instance, in *Richardson Greenshields of Canada Ltd. v. Kalmacoff,*[70] the court held that:

> Although its shares were acquired after the roll-down had been announced and for the express purpose of launching a derivative action,....this does not in itself preclude the appellant from being a complainant. The Act does not impose a condition of ownership contemporaneous with the acts complained of and, in any event, it may be noted that the breaches complained of are of an ongoing nature. It is sufficient that Richardson Greenshields is 'a registered holder...of a security of [the] company' at the time it brings the application.[71]

Second, there is no evidence that there has been blatant abuse of the use of derivative

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[68] See Gordon Phillips, *supra* note 38 at 363-365. The diversity jurisdiction requires that all the parties must be resident or domiciled in different jurisdictions. Since some states in the U.S.A. require security deposit by a shareholder where he owns less than 5% of the company's stock, whereas an action initiated under the Federal Securities Act demands no such requirement, most shareholders preferred to have an accomplice resident in a different state to hold their shares on their behalf and thereafter initiate proceedings ands thereby evade the security deposit requirement.

[69] See *Brambles U.S.A. Inc.v. Blocker*, 731 F.Supp. 643 at 652 (D. Del. 1990).

[70] (1995), 22 O.R. (3d) 577 (C. A.).

[71] *Ibid.* at 583-584.

actions since 1970, in the absence of the contemporaneous ownership rule. Third, there are provisions confering wide discretionary powers on the court for regulating and conducting the derivative action, or to decline an action where it is not convinced of its desirability under the CAMA and ABCA.[72] Lastly, the writer strongly holds the view that a person who buys a share while being aware of a legal wrong in a corporation should be allowed to benefit from his business foresight, awareness and acumen. It may be the case that the selling shareholder being litigation averse may not be interested in pursuing the action. As Robert Clark has suggested:

> ...a cause of action for wrongdoing by directors and officers is part of the assets in which a shareholder has a transferable interest. If a person thinks he has a valid derivative claim against his corporation's directors and officers but is reluctant to start a lawsuit himself---perhaps because he lacks time or is risk-averse---it would appear to be a good thing, for himself and other shareholders, if he could sell his shares to a more daring investor who is willing to act as prosecutor on behalf of all the shareholders. Thus it is difficult to justify the continued existence of the contemporaneous ownership rule.[73]

Thus in *Richardson Greenshields of Canada Ltd. v. Kalmacoff*,[74] the Court of Appeal held that:

> This case is not at all akin to a strike or bounty action, although the appellant purchased shares for the purpose of bringing these proceedings, it is by definition a complainant, and stands, *vis-a-vis* the company, in the same position as any other person who fits within the definition of 'complainant.' The issues involved are of a continuing nature, and it seems to me apparent that the appellant is in a better position than most shareholders to pursue the complaint. Indeed, I see no advantage in requiring that the action be brought by another shareholder, as suggested by the judge hearing the application. I think it significant that the appellant has had a long-standing commercial connection with this class of shares and is familiar with the matters in dispute. It acknowledges that it has clients who purchased shares on its recommendation, and,

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[72] This is discussed in detail under Chapter 5 which deals with the orders that can be made under CAMA s. 304 and ABCA s. 233, and these powers are in addition to the wide discretionary powers the court has to refuse leave.

[73] Robert Clark, *supra* note 59 at 651.

[74] (1995), 22 O.R. (3d) 577 (C.A.).

> it can be inferred from the shareholders' vote, that it voices the views of a substantial number of the preferred shareholders. Whether it is motivated by altruism, as the motions court judge suggested, or by self-interest, as the respondents suggest, is beside the point. Assuming, as I suppose, it is the latter, self-interest is hardly a stranger to the security or investment business. Whatever the reason, there are legitimate legal questions raised here that call for judicial resolution. The fact that this shareholder is prepared to assume the costs and undergo the risks of carriage of an action that may be *ultra vires* and in breach of shareholders' rights does not provide a proper basis for impugning its *bona fides*.[75]

There is now a statutory relaxation of the contemporaneous ownership rule in America. For example in California,[76] a shareholder who was not a contemporaneous owner and who did not become an owner by operation of law, may still bring an action in the discretion of the court. However he must prove that there is a strong prima facie case of the claim, that no similar action has been or likely to be instituted, that he had acquired the shares before the disclosure of the wrong, that it is necessary to permit the action so that the directors will not benefit from their breach of duty, and that the requested relief will not result in unjust enrichment to the corporation or the shareholder.[77]

This is in addition to the continuing-wrong doctrine, under which if the alleged breach or wrongful act had "continued" or lasted till the time the plaintiff acquired his shares, then

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[75] *Ibid.* at 586-587.

[76] Paul P. Harbrecht, "The Contemporaneous Ownership Rule in Shareholders' Derivative Suits" (1978) 25 U. C. L. A. L. Rev. 1041.

[77] See California *General Corporation Law*, s. 800(b)(1) (West, 1990); According to Ernest L. Folk, III, *supra* note 8 at 485-486, "Only one who was a stockholder at the time of the transaction or one whose shares devolved upon him by operation of law may maintain a derivative action. The 'primary purpose' of this requirement is to 'discourage a type of strike suit,' but the statute should not be so construed 'as to unduly encourage the camouflaging of transactions and thus prevent reasonable opportunities to rectify corporate aberrations.' Accordingly, section 327 Delaware *General Corporation Law* will be liberally construed in situations where the 'primary purpose' will not be frustrated thereby. The stockholder need not 'allege that he owns the same stock which he owned at the time of the transaction of which he complains, ' but 'a stockholder-plaintiff must at the time he files his complaint have been the continuous owner of some of the stock held at the time of the alleged wrongful transaction.' For purposes of a derivative suit,an equitable owner is considered a stockholder within the meaning of section 327."

he will not be deprived of standing.[78] In summary, the retention of the contemporaneous ownership rule in the American corporation law is without a valid basis.

The CAMA and ABCA also allow present equitable or beneficial owners of corporation's shares just like present registered holders (legal) of corporate securities shareholders to institute derivative actions.[79] The beneficial owners are deemed in equity to have the same rights as their registered counterparts and any wrongful act affecting the corporation must definitely affect them also. This class was omitted in the original OBCA[80] but O'Leary, J. in *Re Marc-Jay Investments Inc. and Levy,*[81] held that the beneficial owners of the corporation's securities are within the contemplation of the law, and so are allowed to intiate deivative actions.

ii. Former Shareholders

Another topical issue is whether the CAMA and ABCA also permit the former equitable and legal shareholders to institute derivative actions. It has been asserted that since success in every derivative action must primarily benefit the corporation, and indirectly the shareholder, there is no reason to include past shareholders since they are no longer members of the corporation and so will not benefit from the success of the action. This is complicated further by the fact that the two legislations do not specify any limitation as to the period to

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[78] See Robert Clark, *supra* note 59 at 651-652; See also Paul P. Harbrecht, *supra* note 76 at 1041-1066.

[79] The two Business Corporations Acts recognize that there are situations in which the legal beneficiary (who is the real owner of the securities) may not be the actual person named on the corporate records.

[80] See s. 99 of Ontario *Business Corporations Act*, R.S.O. 1970, c. 53; Now replaced by s. 246 of the OBCA 1990 R.S.O. c. B. 16.

[81] (1974), 50 D.L.R. (3d) 45 (Ont. H.C.).

be put into consideration in determining the status of former owners of the corporate securities.[82] It is submitted that a past shareholder even though listed in the legislations only has a rebuttable right to sue, he must prove that he has sufficient financial interest in the company as was laid down in *Re Daon Development Corporation,*[83] and that if his interest is not "a viable one then a motion to dismiss will lie."[84]

The Alberta Institute of Law Research and Reform was of the view that the past shareholder can commence a derivative action only if there is some possibility that the award in the success of the action will be distributed to a class of persons which includes him.[85] Thus in *Jacobs v. Jacobs,*[86] the court ruled that the Acts could not have been intended to cover every former shareholder with the status of complainant for the purposes of bringing derivative actions. The court then went on to give some definition for guidance in determining persons falling into the class of "past shareholders." These are those shareholders connected with the timing of the events consituting the subject matter of the action. The determining factor is whether the injury occured while he was still a member of the corporation.

This writer agrees with this decision, and submits that even where the wrong occurs while the former security owner was a shareholder, he must still prove to the court that he is

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[82] See *Innocan Inc. v. Canadian Pacific Airlines Ltd.*, [1987] R.J.Q. 2451 at 2454 (C.S.), *aff'd* [1991] R. J. Q. 2186 (C.A.).

[83] (1984), 54 B.C.L.R. 235 at 243 (S.C.).

[84] See *Michalak v. Biotech Electronics Ltd.* (1986), 35 B.L.R. 1, affirmed by Quebec C.A.,unreported, April 19, 1989, No. 500-09-001220-862. Though this case concerned statutory oppression remedy, the provisions and the reasoning of the court are instructive in explaining the position of former shareholders.

[85] See *Proposals for a New Alberta Business Corporations Act* Vol. 1 (Edmonton: ILRR, 1980), *supra* note 40 at 147.

[86] Unreported, Ont. Gen. Div., April 23, 1992, Toronto, Action No. 92-CQ-17714.

among the class of persons entitled to the award. In this connection, reference can be made to sections 304(2)(c) and 233(c) of the CAMA and ABCA respectively which allow the court to make an order that proceeds from an award in a derivative actions payable by a defendant be paid, in whole or in part, directly to the former and present security holders of the corporation (or its subsidiary under the ABCA). It is clear that the past shareholder's *locus standi* to sue derivatively is necessarily tied to his being entitled to share in the award to be made by the court.

iii. Creditors of the Corporation

Whether or not the present or past creditors of the corporation should be allowed to institute derivative suits is a moot point. The courts have been hesitant in holding that a creditor is a "complainant" within the contemplation of the legislation. In *First Edmonton Place Ltd. v. 315888 Alberta Ltd.*,[87] the court limited the creditors class to those whose security were capable of being registered. MacDonald, J. granted the complainant leave to sue derivatively but refused the oppression action on the grounds that the debt was not being owed at the time of commencement of the action. On appeal, Stevenson, J. A. overturned the leave granted on the grounds that the derivative action was speculative and premature at its commencement. He however left open the issue whether a derivative action can be permitted in appropriate situations.[88]

At first glance, it appears that every creditor of the corporation is within the

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[87] (1988), 60 Alta L.R. (2d) 122 (Q.B.), reversed on other grounds in (1989), 45 B.L.R. 110(C.A.). According to Harry Sutherland, *Fraser & Stewart Company Law of Canada,* 6th ed., (Scarborough: Carswell, 1993), at 715, the term creditor should be interpreted to cover both persons to whom a debt is owing and those with unliquidated claims for damages.

[88] (1988), 60 Alta L.R. (2d) 122 at 149 (Q. B.).

contemplation of CAMA and ABCA provided that he holds as evidence of his debt obligation either a debenture, debenture stock, bonds, notes or units under a unit trust scheme (under CAMA)[89] or "debt obligation of a corporation and includes a certificate evidencing such a.......debt obligation" (under ABCA).[90] It is important to note that in British Columbia,[91] the court held in *Re Daon Development Corporation* [92] that a debenture holder whose debenture was not yet in arrears and who does not have a *direct financial interest* in the corporation, was not a proper person under section 225(8) of the BCCA. Thus Wallace, J. held that:

> I consider the history of derivative actions and the wording of the section requires that the category be composed of those persons who have a *direct financial interest* in how the company is being managed and are in a position-somewhat analogous to minority shareholders-where they have no legal right to influence or change what they see to be abuses of management or conduct contrary to to the company's interest.[93]

However in other jurisdictions having similar provisions like ABCA and CAMA, the complainant has been held to include a creditor. In *Canadian Opera Co. v. 670800 Ontario Inc.*,[94] the creditor was held to have standing under OBCA to sue as a complainant.[95]

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[89] See CAMA s. 650-(1).

[90] See ABCA s. 1(u); see also *Proposals for a New Alberta Business Corporations Act,* Vol. 1 (Edmonton: ILRR, 1980) *supra* note 40 at 149, where the *Alberta Institute of Law Research and Reform* submitted that the legislative reference to a certificate and the reference to a registered holder probably signifies that the class of the "complainant" extend to those creditors who are entitled to have certificates and who are to be entered in the securities register

[91] The BCCA in s. 225 (1) does not make provision for a creditor like other Provinces. It limits the category to a member or a director of the corporation.

[92] (1984), 54 B.C.L.R. 235 (S.C.).

[93] *Ibid.* per Wallace, J. (1984), 54 B.C.L.R. 235 at 243 (S.C.).

[94] (1989), 69 O.R. (2d) 532 (H.C.).

[95] See also *Cairney v. Golden Key Holdings Ltd (No. 1)* (1987), 40 B.L.R. 263 (B.C.S.C.); *Re Gandalman Investments Inc. and Fogle* (1985), 22 D.L.R. (4th) 638 (Ont. H.C.).

Similarly in *R v. Sands Motors,*[96] the Saskatchewan Court of Queen's Bench held under section 231(b) of the Saskatchewan *Business Corporations Act* [97] that the Crown as "a creditor" was a proper person to sue under the oppression remedy.

As to the "direct financial interest"requirement, it should be noted that even shareholders of the company have no direct financial interest in the company, the only interest they have is "indirect" in the nature of their shareholding, and the right to increase in value in their shares as the company prospers. Thus Gordon Phillips has criticized the *Re Daon Development Corporation,*[98] decision in the sense that:

> It cannot be correct that 'indirect' interest of 'wishing to see the company prosper' is an inadequate interest to justify leave being granted to prosecute a derivative action, for that is precisely the same interest that the shareholders have. Neither shareholders nor creditors have a direct interest in the company's prosperity, but each have an indirect interest, and for the same reason in each case--because the company's prosperity will accrue to their financial benefit: it will increase the value of their shares (if the company is solvent) in the one case, and will increase the likelihood of their receiving complete payment, or else the number of cents on the dollar that they can recover towards their debt (if the company is insolvent and cannot pay that debt in full), in the other case.[99]

It is contended that the best interpretation is that which recognizes the creditor, whether registered or beneficial, as belonging to the class of persons identified as complainants. This is the clear purport of the Acts and their express words say it all, provided a line is drawn between situations where the corporation is solvent and when it is insolvent.

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[96] (1985), 1 W.W.R. 59 (Sask. Q.B.); Also in *Bank of Montreal v. Dome Petroleum Ltd.* (1987), 67 C.B.R. (N.S.) 296 (Alta. Q.B.), *Tsuru v. Montpetit* (1989), R.J.Q. 2452 (C.S.), *Canadian Opera Co. v. 670800 Ont. Inc.* (1990), 75 O.R. (2d) 720 (Ont. Div. Ct.) creditors were allowed to sue as complainant. Also in *Prime Computer of Canada Ltd. v. Jeffrey & Robinson & Jeffrey Ltd.* (1991), 6 O.R. (3d) 733 (Ont. Gen. Div.) An unpaid judgement creditor was allowed to sue as a complainant under the oppression provisions.

[97] *Saskatchewan Business Corporations Act*, R.S.S. 1978, c B-10.

[98] (1984), 54 B.C.L.R. 235 (S.C.).

[99] See Gordon Phillips, *supra* note 38 at 369.

Where the corporation is solvent it may be hard for the creditor to prove his case, but where the corporation is being run at a loss, and the chances of the creditor getting a full repayment on his loan by the corporation becoming very slim and remote, or where there are some corporate facts within his reach which are unknown to the shareholders, then he should be allowed to intiate a derivative action. In this instance, it is safe to say that the provisions of the CAMA and ABCA are more instructive than American laws, because in America the creditors are not recognized as being able to bring derivative actions.[100] Even under the CAMA and ABCA, the creditor's position is not an unassailable one, and Gordon Phillips has therefore submitted that:

> ...a creditor's ability to seek such leave will therefore depend on the particular facts of each case as developed by counsel. It will probably never be possible to give an exhaustive or even a fairly exhaustive list of factors that the courts will consider relevant to this issue but, depending on the circumstances, they may well include the existence, efficacy, and practicality of more traditional debt-collection techniques, whether the debt in question is or is not in default, the commercial sophistication of the creditor, whether the alleged acts in respect of which the creditor wishes to commence a derivative action are said to have been negligent, deliberate, or malicious and in the case of secured creditors whether the creditor is or is not attempting...to enforce its security, and the extent to which the creditor specified the security package that it received.[101]

Based on the recent comments by the courts, one can hope that the courts will do justice in each case given the wide discretionary powers conferred on them by the statutes. Firstly, it is noteworthy that the court in *Re Daon Development Corporation,*[102] left open the issue whether a creditor whose debenture was in arrears would be permitted to sue

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[100] In *Brooks v. Weisner*, 57 F.R.D. 491 at p 494 (S.D.N.Y. 1972), it was held that the right to sue derivatively flows directly from being a co-owner of the corporate assets, and because creditors do not have attributes of ownership nor ownership interest in the corporation, they can not bring actions on behalf of the corporation.

[101] See Gordon Phillips, *supra* note 38 at 373.

[102] (1984), 54 B.C.L.R. 235 (S.C.).

derivatively, and this may be an implied recognition of the creditor's derivative right where the corporation is insolvent. Secondly, the Alberta Court of Appeal which overturned the earlier decision in *First Edmonton Place Ltd. v. 315888 Alberta Ltd.,*[103] as being a hasty action, did not touch the issue whether the creditor was a proper person.

In the case of former creditors, their standing to sue derivatively is not only remote but too rebuttable. Where they are allowed to sue these former creditors, like the former shareholders, have to satisfy the following requirements:

(1). That success of the corporation in the action will benefit them by being among the class of persons to get the benefits of the favourable court's decision;

(2). They must prove sufficient financial interest in the corporation; and

(3). That the injury occured while their debt obligation was still subsisting.

Their case is even made worse in the opinion of Gordon Phillips for the following reason:

> ...there appears to be no case in which anyone has ever suggested that a company's former creditors should share in any part of its award. If they lost their status as creditors because they were paid in full, they have no claim to any additional monies. If they lost that status because they accepted partial payment as part of their compromise, then that compromise is either legally valid and should prevent them from intercepting any part of the company's award, or legally invalid in which case they will be able to set it aside and to become present creditors again.[104]

However it is important to note that neither the Dickerson Committee nor the Alberta Institute of Law Research and Reform made any reference to the inclusion of past creditors in the class of creditors as complainants for the purposes of derivative actions. It is this writer's opinion that where the past creditor can prove to the court that the injury occured

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[103] (1988), 60 Alta. L.R. (2d) 122; *rev'd* in (1988), 71 Alta. L.R. (2d) 61 (Alta. C.A.).

[104] *Ibid.* at 374.

during the pendency of the debt obligation and that success in the action will confer some benefit on him just as he would have been entitled if the directors had acted more prudently in the past, then the court should find him entitled to institute a derivative action. Such award subsequently made will be ordered to be distributed to a class including him under the CAMA[105] and ABCA.[106] In support of the above, sections 304(2)(c) and 233(c) of the CAMA and ABCA respectively are instructive by stating impliedly that former creditors are also former security holders of the corporation. Arguably, they have a statutory standing to sue in so far as they stand to benefit from the award to be made thereby.

b. Present/Past Directors and Officers of the Corporation

Both the CAMA[107] and ABCA[108] allow the current and former directors and officers of the corporation to sue derivatively to enforce corporate rights. The director who, along with other members of the board, have wide managerial powers which include the power to commence corporate litigation, should ordinarily not be given standing as complainants. But this writer holds the view that there are situations where the wrongdoers hold the majority voting powers and at the same time control the board, so that where the "minority director" discovers some fraudulent transaction which he cannot singly prosecute without the support of other board members, then he should be given access to the court. In support, the New

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[105] See CAMA s. 304 (2) c.

[106] See ABCA s. 233 (c).

[107] See CAMA s. 309(b).

[108] See ABCA s. 231(b).

York Court of Appeals held in *Tenney v. Rosenthal*[109] that:

> We may assume that the right to bring suit has been granted in order to facilitate and improve the director's performance of the 'stewardship obligation' which he owes to the corporation and its stockholders. [110]

In the case of officers, it took a long time for the courts to accept that they are now key players in corporate management. However in *Canadian Aero Service Ltd. v. O'Malley (Canaero),*[111] the Canadian Supreme Court recognized that they are sometimes vested with significant managerial powers in some corporations.According to Laskin, J.:

> The distinction taken between agents and servants of an employer is apt here, and I am unable to appreciate the basis upon which the Ontario Court of Appeal concluded that O'Malley and Zarzycki were mere employees, that is servants of Canaero rather than agents. Although they were subject to supervision of the officers of the controlling company, their positions as senior officers of the subsidiary, which was a working organization, charged them with initiatives and responsibilities far removed from the obedient role of servants.[112]

Subsequently the statutes have recognized the growing stature of the corporate officers,[113] and so the rules guiding the standing of directors'ability to sue derivatively should be applicable to corporate officers too.

Concerning former directors and officers of the corporation, it is very apposite that a director or officer who discovers a breach of duty (which occured while he was a director)

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[109] 189 N.Y.S. 2d 158 (1959).

[110] See 189 N.Y.S.2d 158 at 163 (1959). The court went on to hold that a prompt action by the director in such circumstances will "protect him from possible liability for failure to proceed against those responsible for improper management of the corporate affairs."

[111] [1974] 40 D.L.R. (3d) 371 (S.C.C.).

[112] *Ibid.* per Laskin, J. [1974] 40 D.L.R. (3d) 371 at 381 (S.C.C.).

[113] See ABCA s.117(1)(a); CAMA s. 66.

after he has left the corporation should be able to sue.[114] It is strongly contended by this writer that the former director or officer be allowed to institute a derivative action where the alleged wrong led to his removal in the first place.[115]

c. The Director/Registrar/Corporate Affairs Commission

Under the CAMA[116] and the CBCA,[117] the statutes recognize that in some instances the Regulatory Authorities will be the right party to initiate derivative actions. However the ABCA does not make provision for the Director (Registrar) as is recognized under the federal CBCA. According to Gordon Phillips:

> The 'Director' is the relevant provincial or federal government official charged with a certain amount of responsibility for overseeing corporate affairs.[118]

In a few cases,[119] the Director has been recognized as "*parens patriae*" to institute

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[114] See Gordon Phillips, *supra* note 38 at 381.

[115] See *Tenney v. Rosenthal,* 189 N.Y.S. (2d) 158 at 164 (1959), where the New York Court of Appeals held that "...It may well be that a majority of the shareholders in a close corporation will vote against a director who properly insists that the corporation be managed for the benefit of all the shareholders, rather than only of the majority. Or, it may happen in a publicly held corporation that the proxies of quiescent shareholders will be voted against a director who has sought to expose wrongdoing by the same dominant directors who actually cast the votes.."

[116] See CAMA s. 309(c).

[117] See *Canada Business Corporations Act,* R.S.C. 1985, c. C-44 at s. 238(c). Further under section 248(1) of the OBCA, the Ontario Act allows the Ontario Securities Commission, in case offering corporations, to apply for relief. Thus in *Ontario Securities Commission v. McLaughlin* (1987), 11 O.S.C.B. 442 (Ont. Div. Ct.) the Commission was granted leave as a complainant even though the concerned corporation had ceased to be an offering corporation, based on acts performed by the corporation while it was an offering corporation.

[118] See Gordon Phillips, *supra* note 38 at 381-82; see also Professor C. O. Okonkwo, "The Corporate Affairs Commission," in E. O. Akanki, ed., *Essays On Company Law* (Lagos: University of Lagos Press, 1992) 14.

[119] *Sparling v. Southam Inc.,* [1988] 66 O.R. (2d) 225 (Ont. H.C.); *Sparling v. Royal Trustco Ltd.,* [1984] 6 D.L.R. (4th) 682 (Ont. C.A.); *aff'd* [1986], 2 S.C.R. 537; *Sparling v. Javelin International Ltd. (No. 1),* [1986] R.J.Q. 1073 (Que. S.C.); *Sparling v. Javelin International Ltd. (No. 2),* [1987], R.J.Q. 1554 (Que. S.C.).

actions in Canada. In most cases necessary facts to support the minority shareholder's claim may not be within his reach, whereas these facts are usually within the reach of the Director. As Cory, J. noted in *Armstrong v. Gardner,*[120] "[A]lmost invariably minority shareholders will be in such a disadvantageous position that they will not be able to obtain first-hand evidence and information upon which to found their motion..." The importance of allowing the Director (or the Registrar under the ABCA) to sue derivatively was also recognized by the Dickerson Committee that:

> ...it will almost certainly be true in many cases that even the most sophisticated litigative weapons will be valueless for lack of information as to the details of suspected mismanagement. That information is, by its very nature, likely to be known by the suspected wrongdoers and unlikely to be known by or voluntarily disclosed to those seeking to complain of the suspected wrongdoing.[121]

It is the same reasoning that informed the inclusion of the Nigerian Corporate Affairs Commission (hereinafter "the CAC") as an applicant under CAMA. By this, the CAC has in addition to its power of investigation under section 312 of CAMA,[122] the standing to institute derivative actions, thus making it assume the role of "Corporations Ombudsman" proposed

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[120] See Cory, J. in (1978), 20 O.R. (2d) 648 at 652 (Ont. H.C.).

[121] See *Proposals for a New Business Corporations Law for Canada, (the Dickerson Report)* Vol. 1 (Ottawa: Information Canada, 1971) at para. 464. Further, according to Harry Sutherland, Q. C. in *Fraser & Stewart Company Law of Canada,*6th ed., (Scarborough: Carswell, 1993) at 708-709 a literal interpretation of the *proper person* provision may seem to imply that anyone is allowed to bring an action on behalf of other security holders, even though no wrong has been done to the applicant himself provided he qualifies as an applicant, however case law has insisted that the complainant proves that the wrongful conduct relate to or harm him directly. Thus in *Re Abraham and Inter Wide Investments Ltd.* (1985), 51 O.R. (2d) 460 (Ont. H.C.), *Goldbelt Mines Inc. (N. P. L.) v. New Beginnings Resources Inc.* (1984), 28 B.L.R. 130 (B.C.C.A.) and *347883 Alberta Ltd. v. Producers Pipelines Inc.* (1991), 4 W.W.R. 151, *rev'd* in (1991), 4 W.W.R. 577 (Sask. C.A.), the court insisted that the party must prove direct prejudice or harm to qualify as a complainant.

[122] See E. Oladeji Akanki, "Reformulating the Law Against Oppression in Companies" (1990/91) Vol. 13, 14 & 15 The Journal of Private and Property Law 19 at 34.

by Wedderburn.[123] In this instance the CAMA is wider than ABCA, though it is appreciated that the level of awareness of an average shareholder in Canada is higher than what obtains in Nigeria, and that the factors that might seem very flagrantly opposed to the well being of the corporation to compel the Director (or the Registrar) to intervene in wrongful intra-corpoarte activities might be absent in Canada.

d. The "Proper Person" Residual Category

Under the CAMA and ABCA the court is given the discretionary power to permit any other person who in the opinion of the court is a "proper person" to sue derivatively on a corporate wrong or breach of directors duties.[124] This provision has been interpreted to cover creditors where they were otherwise not permitted to sue as registered holders or beneficial owners of corporate securities.[125] The provisions of the CAMA and ABCA can be contrasted to the BCCA, in that under the former Acts the "proper person" clause is inserted as part of the broad definition of the complainant (applicant), while under the BCCA[126] it is included under the expanded definition of the "member." It has thus been used under the BCCA to permit an action by a shareholder of a parent corporation to sue for a breach of duty by the subsidiary's directors.[127] However in *Re Daon Development Corporation,* where the debenture

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[123] See K.W. Wedderburn, "A Corporations Ombudsman" (1960) 23 Mod. L. Rev. 663; (1983) 43 Mod. L. Rev. 643.

[124] See CAMA s. 309(d); ABCA s. 231(b) (iii).

[125] See *Re Daon Development Corporation* (1984), 54 B.C.L.R. 235 (S.C.).

[126] See BCCA s. 225(b).

[127] See *Ginther v. Rainbow Management* (1989), unreported (B.C.S.C.) No. A890240, Vancouver Registry; (1989), affirmed by B.C.C.A., unreported (B.C.C.A.) No. CA010720.

holder whose debt was not yet in arrears sought leave to sue derivatively, the court held that: [128]

> In my judgment, some insight into the category of persons the legislature had in mind as being a 'proper person' is gathered from the inclusion in s. 225 of 'director' and 'member' in the class of persons entitled to bring the application with leave of the court. Obviously, if 'any person' may apply to bring such an action there is no need for directors or members to be specifically singled out as having that privilege....[the proper person] must have a direct financial interest in how the company is being managed...somewhat analogous to minority shareholders -where they have no legal right to influence or change what they see to be abuses of management or conduct contrary to the company's interest.[129]

In *Benarroch v. City Resources (Can.) Ltd.*,[130] it was held that a director does not have a *direct financial interest* in the way the corporation is managed to qualify as a complainant. In *Lee v. International Consort Industries,*[131] the court held that the proper person to sue derivatively might not be a proper person to seek a remedy for oppression:

> It should be borne in mind that *Re Daon* was concerned with status to bring a derivative action. Wallace, J. (as he then was) did not say that there is the requirement of a direct financial interest in how the company is being managed on one seeking status under s. 224(6). However, it is clear that Lee did not have a *direct financial interest* in how Consort was being managed. Further, in my opinion, he is not in a somewhat analogous situation to that of a minority shareholder. Section 224...(6) (b) was enacted to cover the cases of persons in unforeseeable situations who ought to be included. However, in my view, the class is small.[132]

Perhaps the best definition of the "proper person" complainant is that stated in *Anthony v. Haunted Hills Grazing Co-Operative Ltd.:*[133]

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[128] (1984), 54 B.C.L.R. 235 (S.C.).

[129] *Ibid.* at 235-236.

[130] (1991), 54 B.C.L.R. (2d) 373 (C.A.).

[131] (1992), 63 B.C.L.R. (2d) 119 (C.A.).

[132] *Ibid.* at 129.

[133] (1991), 86 D.L.R. (4th) 226 at 240 (Sask. Q.B.). However it is important to note that this particular court was interpreting s. 188 (b) of the *Saskatchewan Co-Operative Act*, S.S. 1983, c. C-37 containing identical provisions defining a "complainant" as the derivative action provisions in most Canadian provincial

> Taken together those sections only extend protection to members, other security holders, creditors, directors and officers of the corporation. Conceivably a court might allow a person, who does not fall into any of those categories, to apply for relief under (the residual category) but the relief sought would have to be for the benefit of a person in the enumerated group....Those provisions do not allow a non-member to gain admission by invoking the catch-all clause. [134]

This writer strongly holds the view that the "proper persons" category should be limited to the complainant in the class of those persons expressly mentioned in the statutes, i.e. the owners of the corporation's securities, the company's directors and officers, and the Director (or the Registrar). Any other person not expressly mentioned in the Companies Acts, must prove to the court that he is foreseeably within the class of the above-mentioned, that the claim is not vexatious or frivolous, that the success of the action will confer a direct benefit on the corporation; and that the action will confer a residual benefit on a class of persons including him. Surely the legislators did not intend to create busybodies and professional litigants out of the public, and so the class should have an identifiable limit.

VII. The Courts in which Derivative Actions may be Brought

Section 232(1) of the ABCA allows the complainant to apply to "the Court" for leave, and in this connection, the Court has been defined to be "the Court of Queen's Bench of Alberta."[135] But this is not to mean that, for instance, shareholders residing in Winnipeg, Manitoba of a company incorporated in Alberta can commence derivative proceedings only

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corporations legislations.

[134] *Ibid.* at 240.

[135] See ABCA s. 1(g). This is the same as all other Canadian Provinces except Yukon and British Columbia where "the Court" is defined as the Supreme Court. Under the federal statute-CBCA, s. 2 (1) defines "the Court" as "a provincial superior court of first instance"(i.e. the provincial courts of Queen's Bench.) In this connection it is suggested that the British Columbia and Yukon provinces amend their laws that the court should be courts of Queen's Bench in order to achieve uniformity.

in an Alberta court. They can commence action in Winnipeg provided they comply with the rules of the court governing jurisdiction in Manitoba. However the Manitoba court will apply the provisions of the ABCA by virtue of conflict of law rules.[136]

In Nigeria, the court to which an applicant may apply under section 303(1) of CAMA has been defined to mean "the Federal High Court, and to the extent to which application may be made to it as; court also includes the Court of Appeal and the Supreme Court of Nigeria."[137] The effect of this is that the CAMA allows the applicant to apply to a Superior Court of first instance, equivalent to a Canadian provincial Court of Queen's Bench, subject to a right of appeal to the Court of Appeal and ultimately to the Supreme Court of Nigeria. However the CAMA provisions are in conflict with section 236 of the Nigerian Federal Constitution.[138] Section 236 of the Nigerian Federal Constitution provides that the High Court of a state shall have "unlimited jurisdiction."[139] This unlimited jurisdiction has been interpreted as a constitutional provision which cannot be derogated from by an Act of the

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[136] Generally American courts have evolved a lot of conflict of laws rules in this regard. Under the "Vested Rights Approach of the First Restatement of Conflict of Laws," the court will determine what area of the law is at issue, and thereafter determine where the rights in issue vested. Secondly, the court may adopt the "Substantial Relationship Approach of theSecond Restatement of Conflict of Laws," by which the court will use the law of the jurisdiction with the most significant relationship to the claim at issue. By this, the court looks at all the relevant facts, where the relevant events occured, and the policies of the states whose laws are being considered, then whichever state has the most substantial relationship parties and events in question will have its law applied. Thirdly, under the "Governmental Interest Approach," the forum court will generally apply its own substantive law, except where there appears to be a conflict between the forum state's law and another jurisdiction having interest in the matter, the court will look to see if there is really a conflict. Where there is a real conflict, the court will then apply the law of the jurisdction with most substantial interest in the claim.

[137] See CAMA s. 650(1).

[138] *Federal Republic of Nigeria Constitution*, 1979.

[139] See J. Aigbuloko Oyakhirome, "Fair Trial is the Casualty" in Emeka Chianu, ed., *Legal Essays in Honour of Professor Sagay* (Benin City: Department of Public Law, University of Benin, 1996) Essay Three, 72 at 76-77.

Legislature.[140] In effect an applicant can apply either to the Federal High Court or to the State High Court in order to institute a derivative action based on a breach of the directors duties or corporate wrongs.

Unlike the American situation, the issues of conflict of laws do not arise here as section 54 of the CAMA requires every foreign corporation intending to carry on business in Nigeria to take all steps necessary to be reincorporated as a separate company in Nigeria. Until it is so incorporated, the company shall not carry on business in Nigeria. After re-incorporation, the company shall be subject to derivative proceedings under the CAMA like all other local companies.This is against the background that Nigeria has a unitary federal corporation law system, and company law is under the exclusive list which the constitution has reserved exclusively for the federal parliament.

VIII. The Nature of the Corporate Wrong

The American decisions have over the years devised some rules governing the nature of corporate wrong complained of, and according to Stanley Nemser:[141]

> The complaint should not be a 'bare bones' pleading in a shareholder's derivative action. The complaint must allege with particularity the efforts, if any, made by the shareholder plaintiff to obtain the action he desires from the directors and, if necessary, the shareholders, and the reasons for his failure to obtain the action or for not making the effort. The facts and circumstances constituting the fraud alleged in the complaint must be stated with particularity.[142] Such statement of facts must not be entirely conclusory in nature, although it may be pleaded

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[140] See *Acqua Ltd.v. Ondo State Sports Council* (1988), 10 & 11 S.C.N.J. 26 at 52-53 (Nig. S.C.), where Karibi-Whyte, J.S.C. held that: "It is elementary and fundamental proposition that a fundamental proposition that a right conferred by the Constitution cannot be taken away by any other provision except the Constitution itself."

[141] See Stanley Nemser, *supra* note 6 at 83.

[142] See Rule 9(b), American *Federal Rules of Civil Procedure,* as amended (1993).

on information and belief. [143]

The grant of leave is not automatic upon the allegations being made. Sufficient particularities of acts constituting breach of duties by the directors must be pleaded clearly by the minority, even if it is based on affidavit evidence only. Generally, the wrongs that are litigated are breaches of the fiduciary and legal duties occasioning injuries to the corporation itself.[144]

IX. The Prerequisite Steps

Both the CAMA and the ABCA, in order to weed out flimsy, vexatious and frivolous claims, stipulate almost similar procedural steps to be undertaken by the minority shareholder towards instituting a derivative suit.[145] These requirements[146] are substantially identical under both Companies Acts save for the inclusion of the requirement that the wrongdoers be the directors in control of the corporation and will not take necessary action under section 303(2)(a) of the CAMA. Apart from this notable difference, the requirements of notice, good faith and corporation's best interests are to be found in both pieces of statutes.

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[143] See also *Segal v. Gordon*, 467 F.2d 602 (2d Cir. 1972).

[144] A more detailed discussion of the difference between corporate and personal/direct injuries is carried out in Chapter 6.

[145] See CAMA s. 303(2) (a),(b),(c) & (d); ABCA s. 232(2) (a),(b) & (c); In this connection Bruce Welling noted:"these are designed to weed out frivolous and unnecessary actions without wasting judicial time," see Bruce Welling, *Corporate Law in Canada: The Governing Principles,* 2nd ed., (Toronto: Butterworths, 1991) at 580.

[146] See generally Lowell E. Sachnoff, "Determining The Basic Prerequisites for a Class Action" in Stuart D. Weschler and Selma Arnold, eds., *Prosecuting and Defending Stockholder Suits* (New York: Practising Law Institute, 1972) 67. See also *Wallersteiner v. Moir (No. 2),* [1975]1 All E.R. 849 (C.A.), where for the first time in England, the derivative rights of a minority shareholder was be recognized. Lord Denning made express allusion to the fact that derivative rights provisions were developed to a very advanced stage in America; see also L. S. Sealy, "Problems of Standing, Pleading and Proof in Corporate Litigation" in B. Pettet, ed., *Company Law in Change* (London: Stevens & Sons, 1987) 1.

a. The Requirement of Control [147]

Section 303(2)(a) of CAMA requires that the wrongdoers should be the directors who are in control and will not take necessary action. According to Dennis Peterson:

> One precondition to obtaining leave for a statutory derivative action is that 'the directors of the corporation or its subsidiary do not bring, diligently prosecute or defend or discontinue the action' in which the complainants wish to intervene. The most obvious way that directors can fail to take action is by a direct refusal to do so. Presumably silence can also indicate refusal, provided the directors had sufficient notice and reasonable time to consider the complaints.[148]

Lord Blanesburgh in *Ferguson v. Wallbridge,*[149] recognized that a minority action must be permitted as a special procedure in order to avoid a situation in which the minority must lose his right because the wrongdoers control the company. He observed that it is "an excellent illustration of the golden principle that procedure with its rules is the handmaid and not the mistress of justice."[150] It is this control, either by influence or ownership of a majority of shares, by the board or the controlling majority that will ground that will ground the derivative suit. According to Wedderburn:[151]

> [T]he easiest way to prove control of a company...is to show that the persons against whom the allegations are made own a majority of the shares which confer voting rights-although it is quite clear today that *de facto* control can be obtained in a large company by the acquisition of a much smaller block of fifty per cent, because of failure of members to attend meetings. It is usual for the courts to go behind the register of members in determining ownership of shares;....Danckwerts J. was recently prepared to go as far as the investigation of nominee

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[147] See the previous discussion in Section IV (d) of Chapter 2 on the"Fraud on the Minority Exception" as provided under s. 300(d) of the CAMA .

[148] See Dennis H. Peterson, *Shareholder Remedies in Canada* (Toronto: Butterworths, 1989) at para. 17.36.

[149] [1935] 3 D.L.R. 66 (P.C.).

[150] *Ibid.* per Lord Blanesburgh at 81.

[151] See K.W. Wedderburn, "Shareholders' Rights and the Rule in *Foss v. Harbottle*" (1958) Cam. L. J. 93 at 94.

shareholding, in *Pavlides v. Jensen,*[152] in order to determine who was in control.

Thus once the shareholder can prove control *de facto* or *de jure,*[153] the minority should be allowed to institute a derivative action. In *Omisade v. Akande,*[154] factual control was evident, even though the two shareholders each held 50% of the corporation's total shareholding. Further in *Russell v. Wakefield,*[155] Jessel, M.R. had held that where the wrongdoers have a majority of votes, or there has been approval of the "fraud" by the majority, or the corporation has otherwise shown that it is not willing to sue, then the minority action can be permitted. Once there has been a wrong or breach of duty by the directors having control, it follows necessarily that they will not take necessary action to redress the injury, a fact which can be shown by the passage of time after the minority has required the directors to take appropriate action.[156]

However this writer submits that control is almost always a practical issue which may not be very obvious in all the cases. Therefore the requirement is merely superfluous and amounts only a common law legacy, thus the Nigerian law makers should expunge it from their law, and the courts are advised not to lay much emphasis on it.

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[152] [1956] 1 Ch. 565 at 577 (Ch.D.).

[153] In Chapter 2, *supra* under the fraud on the minority exception to the *Rule in Foss v. Harbottle,* we examined various ways in which control by the majority may be proved.

[154] (1987), 2 N.W.L.R. 158 (Nig. S.C.).

[155] (1875), L.R. 20 Eq. 474 at 482 (Ch. D.), where Jessel, M.R. held that "...if it can be shewn either that the wrongdoer has command of the majority of the votes, so that it would be absurd to call the meeting; or if it can be shewn that there has been a general meeting substantially approving of what has been done; or if it can be shewn from the acts of the corporation as a corporation, distinguished from the mere acts of the directors of it, that they have approved of what has been done, and have allowed a long time to elapse without interfering, so that they do not intend and are not willing to sue."

[156] *Birch v. Sullivan,* [1958]1 All E.R. 56 (Ch. D.).

b. Notice to the Directors of the Applicant's Intention to Apply to the Court

The CAMA and ABCA respectively require the minority shareholder to give reasonable notice to the directors of his intention to apply to the court for leave to prosecute the claim derivatively.[157] According to Bruce Welling:

> The first prerequisite is notice to those who otherwise have the power to commence corporate litigation...[T]he message is clear: no complainant can be permitted to proceed without proof that he has recommended to the board of directors that they take action and that it is unlikely that they will do so. The former can usually be accomplished by a written request to the board or by serving them with notice of the application. The latter can be shown by the lapse of time since notice was given, the lack of any indication that the directors seem inclined to proceed, or the applicant's simple allegation that the directors are not proceeding for some improper motive.[158]

Failure to give notice to the directors so as to permit them to take action will be fatal to the complainant's application.[159] There are various reasons for the notice requirement. First, it helps to implement the basic principle that management of the corporation is to be entrusted to the board who decides on whether to sue or not. The power to commence litigations on behalf of the corporation is ordinarily a business judgement for the board to make. Second, it aids judicial economy due to the fact that service of a notice on the board may lead to a corrective action short of litigation, and where the directors action is binding,

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[157] See generally CAMA s. 303(2)(b); ABCA s. 232(2)(a); Stein Gundmunseth & Sandra Draibye, "Derivative Actions" in Gordon Phillips, ed., *Remedies For Corporate Injuries* (Vancouver: The Continuing Legal Education, 1993) at 3.1.09; Bruce Welling, *supra* note 145 at 527-28; Gordon Phillips, *supra* note 38 at 383-390. It should be noted however that in Ontario, under the OBCA s. 246(2), the complainant has to show that he has given fourteen days' notice to the directors. While in British Columbia under s. 225(3)(a) of BCCA, the complainant must show that "he has made reasonable efforts to cause the directors of the company ...." However both the OBCA's "fourteen days" and the BCCA's "reasonable efforts" appear, in practice, to have no major difference to the derivative rights of the minority under the Acts. See also D. A. Demott, "Demand in Derivative Actions: Problems of Interpretation and Function" (1985) 19 U. C. Davis L. Rev. 461.

[158] See Bruce Welling, *supra* note 145 at 527-528.

[159] *Covia Canada Partnership Corp. et al. v. PWA Corp. et al.* (1993), 105 D.L.R. (4th) 60 (Ont. Gen. Div.).

then the court's time is saved from examining business decisions in place of more qualified professional managers, while leaving time for the court to handle more important matters. Third, it protects the board from harassment by litigious shareholders who might be wishing to challenge an otherwise valid business decision. Fourth, it helps to discourage "strike suits" based on reckless charges and personal gain.[160] The contents of the notice required must be very clear as to the desired action. As Dennis Peterson submitted:

> The courts have interpreted the 'reasonable notice' requirement in form and substance as a simple, straightforward communication to the directors of the company or its subsidiary by a complainant that some action be taken regarding a corporate derivative action....the case law suggests that a notice need not describe the cause of action with perfect clarity, but it should contain enough information to determine the nature of the complainant's concerns and be delivered to the appropriate parties.[161]

The notice must be given by the applicant himself, so that notice given by another shareholder will not suffice for another shareholder.[162] In the U.S.A., the courts have specified at least three essential elements that must be present for a communication to constitute an effective notice on the board.The notice must state (1) the identity of the alleged wrongdoers; (2) the wrongdoing they allegedly perpetrated and the resultant injury to the corporation; and (3) the legal action the stockholder wants the board to take on the corporation's behalf.[163]

Courts in Canada have required less formality as to the way the notice must be

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[160] See generally Robert Clark, *supra* note 59 at 641.

[161] See Dennis H. Peterson, *supra* note 148 at para. 17.37.

[162] *Johnson v. Meyer* (1987), 57 Sask. R. 161 (Q.B.).

[163] Edward Welch & Andrew Turzeyn, *Folk on the Delaware General Corporation Law: Fundamentals*, 1998 ed., (New York: Aspen Law & Business, 1998) at 851.

framed, for example Cory, J. held in *Armstrong v. Gardner,*[164]

> [A]lthough the letters requesting action were not framed with great particularity as to the cause of action to be brought, they were directed to a solicitor. I think that there was a sufficient demand made to bring an appropriate action by the two letters sent on behalf of the minority shareholders....I do not think that this section...ought to be construed in an unduly technical or restricted manner.[165]

It would appear that all that is important is that the notice must get to the directors attention presumably at the corporate office. It must be in such clear terms as to the nature of the wrong alleged, the type of action required from the directors, and show an intention to apply to the court if no action is taken.[166] Thus it has been held that the applicant must give the directors notice of the specific cause of action it wishes them to pursue.[167] However Nemetz, C.J.B.C. in *Bellman v. Western Approaches Ltd.,*[168] has opined that "failure to specify each and every cause of action in a notice does not, in my opinion, invalidate the notice as a whole."[169] Gordon Phillips has argued that "...the arrival of the notice at the company's registered office should constitute the giving of notice to the various directors."[170]

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[164] (1978), 20 O.R. (2d) 648 (Ont. H.C.).

[165] *Ibid.* per Cory, J. at 652.

[166] See Gordon Phillips, *supra* note 38 at 383-390, where he wrote that, "presumably a letter addressed to the directors, and sent to the registered office of the company, will suffice; it will be impractical to interpret the statute as requiring the applicant to send the requisite notice to each director...minimum amount of information about the basis of the proposed action must be to the directors."

[167] *Re NorthWest Forest Products Ltd.,* [1975] 4 W.W.R. 724 (B.C.S.C.).

[168] (1981), 33 B.C.L.R. 45 (C.A.).

[169] *Ibid.* per Nemetz, C.J.B.C. in *Bellman v. Western Approaches Limited* (1981), 33 B.C.L.R. 45 at 53 (C.A.); In *Re Olympia and York Enterprises and Hiram Walker* (1986), 59 O.R. (2d) 254 at 274 (Ont. Div. Ct.), Montgomery, J. was of the opinion that he would have allowed a derivative action if it was only the notice requirement that was not met by the applicant provided he fulfilled the other conditions of s.246(2) OBCA.

[170] See Gordon Phillips, *supra* note 38 at 384.

Echoing the American "particularized notice" doctrine, Scott Turner has proposed that:

> A proponent of a derivative action, whether it proceeds by way of a letter to the directors or seeks to convene a meeting of shareholders, should attempt to be as specific as possible as to the nature of the causes of action the proponent wishes the company to pursue and should attempt to lay out as precisely as possible the facts upon which the allegations are based. It is probably also good practice to draft a proposed statement of claim or, in any event, make some attempt at precisely framing the nature of the complaints and the causes of action asserted. The less detail that is provided, the more difficult it is for the company to respond.[171]

This writer agrees that the applicant will satisfy the requirement by serving a clear written statement of his allegations at the company's registered office, and the burden automatically shifts to the directors to commence legal action. If they will not, then the shareholder had met the requirement of notice. Thus Welch and Turezyn[172] have observed that the demand contemplated in Rule 23.1[173] is a form of *notice* designed to afford to the corporation's board an opportunity to consider the facts asserted and to exercise its business judgement whether to press any arguable claim the corporation may possess or to take other actions.[174]

After submitting the notice to the board, the shareholder must wait for a reasonable period of time before filing the suit, or the suit will be dismissed as premature.[175] In *Rubin v. Posner,*[176] it was held that what will constitute a reasonable time will depend on the

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[171] Scott Turner, "Derivative Actions" in The Council of Legal Education Society of British Columbia, *Shareholders' Remedies* (Materials Prepared for the Continuing Legal Education Seminar, *New Developments in Shareholders' Remedies,* Held in Vancouver, B. C. on November 28, 1996) at 1.1.16.

[172] Edward Welch & Andrew Turezyn, *supra* note 163 at 831.

[173] U. S. *Federal Rules of Civil Procedure,* as amended (1993).

[174] *Schick Inc. v. Amalgamated Clothing & Textile Workers Union,* 533 A.2d 1235 at 1240 (Del. Ch. 1987).

[175] Edward Welch & Andrew Turezyn, *supra* note 163 at 832.

[176] 701 F.Supp. 1041 (D. Del. 1988).

circumstances, and no magical period of time exists by which to measure whether suit was filed prematurely.[177] The time required is to enable the board to investigate and respond to the claim before filing suit, which "will vary in direct proportion to the complexity of the technological, quantitative and legal issues raised by the demand."[178] Thus in *Chanral Investment Co. v. Rockefeller,*[179] the Delaware Court of Chancery held that because the impugned transactions had occured over an eight-year period and involved several millions of U. S. dollars, the investigation following the demand may reasonably take several months.

On getting the notice, the board must carry out a reasonable and thorough investigation, and must consider all the alternative corrective internal actions that will take care of the shareholder's grievance. Thus the Delaware Supreme Court noted in *Rales v. Blasband:*[180]

> The task of a board of directors in responding to a stockholder demand letter is a two-step process. First, the directors must determine the best method to inform themselves of the facts relating to the alleged wrongdoing and the considerations, both legal and financial, bearing on a response to the demand. If a factual investigation is required, it must be conducted reasonably and in good faith. Second, the board must weigh the alternatives available to it, including the advisability of implementing internal corrective action and commencing legal proceedings. In carrying out these tasks, the board must be able to act free of personal financial interest and improper extraneous influences.[181]

Thus the general rule in America is that a shareholder before instituting a derivative action is required to make a demand upon the directors to institute such suit, and to afford

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[177] *Ibid.* at 1045.

[178] *Allison v. General Motors Corp.*, 604 F.Supp. 1106 at 1117-1118, (D. Del. 1985) *aff'd,* in 782 F.2d 1026 (3d Cir. 1985).

[179] C. A. No. 14397, slip op. at 5 (Del. Ch. Nov. 7, 1995).

[180] 634 A.2d 927 (Del. S.C. 1993).

[181] *Ibid.* at 935.

the directors reasonable time to either refuse or to have the corporation bring suit, unless such demand would be futile and useless.[182] Demand is considered futile where the majority of the shareholders are the wrongdoers,[183] or where the majority are under the control of the defendants.[184]

A demand is also futile where the theoretically independent disinterested board cannot be expected to weigh impartially a charge against their accused colleagues. [185] Where the time necessary for making a demand on directors is ordinarily short that irreparable injury to the corporation will probably occur, demand will normally be excused. Thus in *Kaplan v. Peat Marwick, Mitchell, and Co.*,[186] the court noted that the shareholder's complaint must allege self-dealing or bias on the part of a majority of the Board of Directors to state an adequate reason for excusing demand.[187] Also in *Bergstein v. Texas International Company*,[188] the court held that a demand in a derivative suit was unnecessary when all the directors were named as defendants and were either benefited by a plan creating share appreciation rights or where they had made incomplete or misleading statements to the shareholders about the plan

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[182] See Stanley Nemser, *supra* note 6 at 77.

[183] *Reed v. Hollingsworth,* 135 N.W. 37 (1912).

[184] *Citrin v. Greater N.Y. Indus. Inc.*, 79 F. Supp. 692 at 697 (S.D.N.Y. 1948).

[185] *Pomerantz v. Clark,* 101 F.Supp. 341 at 344 (D.Mass. 1951). In *Barr v. Wackman,*329 N.E.2d 180 (N.Y.C.A. 1975) the shareholders alleged that the 16 insider directors had breached their fiduciary duties by taking bribes in facilitating acertain merger and acquisition. Five of the corporation's directors were inside directors who were actively involved in the deal. Eleven unaffiliated directors had approved and ratified the deal. The New York Court of Appeals held that this will justify waiver and excuse of the demand requirement.

[186] 529 A.2d 254 (Del. Ch. 1987).

[187] See also *Garber v. Lego, et al.*, 11 F.3d 1197 (3d Cir. 1993); *Andreae v. Andreae,* 1992 De. Ch. Lexis 44 (March 5, 1192); *In re Baxter International, Inc.*,654 A.2d 1260 (Del. Ch. Ct. 1995).

[188] 453 A.2d 467 (Del. Ch. 1982).

in order to get it approved. Further in *Barr v. Wackman,*[189] the court held that the participation in and approval of acts which involved bias and self-dealing by the minority affiliated directors on the one hand, and a breach of the fiduciary duties of due care and diligency by the remaining majority unaffiliated directors will excuse the shareholder's failure to make a demand. In *Boyko v. Reserve Fund Inc.*,[190] because of the close relationship of the investment adviser and the fund, control of the fund by the investment adviser and the participation of the fund's directors in the alleged wrongful acts, the court held that it would be futile to demand the mutual fund's directors to bring action. In most cases, allegations of domination and control and/or participation and acquiscence of the directors in the wrongs complained of have been held sufficient to excuse demand in America.[191]

While participation and involvement of the impugned directors will clearly justify excuse of demand, the mere allegation of acquiescence and approval of the deal by other directors will not render notice futile in all cases. In trying to identify when demand will be excused, the American courts have evolved various tests. For example in *Barr v. Wickman*,[192] the New York Court of Appeals excused notice on the ground that apart from the fact that five of the corporation's directors were guilty of actual participation in the wrong by authorizing and approving the wrongful merger and acquisition, the remaining unaffiliated

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[189] 329 N.E.2d (N.Y.C.A. 1975).

[190] 68 F.R.D. 692 (S.D.N.Y. 1975).

[191] *Nussbacher v. Continental Illinois National Bank,* 518 F.2d 873 (7th Cir. 1975).

[192] 329 N.E.2d 180 (N.Y.C.A. 1975).

eleven directors had approved the deal. Contrarily, in *re Kaufmann Mutual Fund Actions,*[193] it was held that mere approval of corporate action, absent self-interest or other indication of bias, cannot be the sole reason for excusing demand, since the directors are generally, by virtue of their managerial duties, to consider and approve advisory contracts. The court distinguished cases where a director goes along with a colleague in an act, on its face advantageous only to the colleague alone and not to the corporation, from cases where the director merely made an erroneous business judgement in approving an apparently corporate act, though another director may have an underlying personal benefit.[194] Thus Robert Clark had submitted that:

> *Kaufmann* and other cases do show that courts will not simply accept conclusory allegations that independent directors were controlled or dominated by wrongdoing affiliated directors. Plaintiffs must allege particular facts showing domination or control.[195]

In determining whether demand is futile, unnecessary or excused or whether the director's act is valid based on business judgement rule (which will cover erroneous good faith business decisions),[196] the Delaware Supreme Court in *Aronson v. Lewis*[197] stipulated that the court must decide:

> Whether, under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the

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[193] 479 F.2d 257 (1st Cir. 1973), cert. denied, 414 U. S. 857 (1973).

[194] *Ibid.* 479 F.2d 257 (1st Cir. 1973) at 265.

[195] Robert Clark, *supra* note 59 at 643.

[196] The Business Judgement Rule provides that the court will not hold directors liable for mere errors of judgement, absent intentional misconduct, illegality and improper benefit. This is based on the presumption that in making a business decision, the directors acted on an informed basis, in good faith, and in honest belief that the action taken was in the best interests of the corporation.

[197] 473 A.2d 805 (Del. S.C. 1984) *rev'g* 466 A.2d 375 (Del. Ch. 1983).

> product of a valid exercise of business judgement. Hence, the Court...must take two inquiries, one into the independence and disinterestedness of the directors and the other into the substantive nature of the challenged transaction and the board's approval thereof.[198]

The premise of a valid futility claim is that a majority of the board either has a financial interest in the challenged transaction or is dominated, controlled and influenced to the extent that it lacks independence or otherwise fails to exercise due care.[199]

The first part of the test in *Aronson v. Lewis* requires that the court should verify whether a reasonable doubt is created as to the disinterestedness or independence of the board in approving the impugned deal. In *Pogostin v. Rice,*[200] it was held that a director is *interested* whenever divided loyalties are present. Further it was held that the directors would be interested they have received, or are entitled to receive personal benefits from the challenged transaction which are not equally shared by other shareholders.[201]

The *independence* of the directors would be questioned based on the analysis of the factual allegations pertaining to the influences upon the directors performance of their duties generally, and more specifically in respect to the challenged transaction.[202]

Second, the court must focus on the substantive nature of the challenged transaction and the board's approval thereof and determine whether a "reasonable doubt" exists at the threshold that the challenged action was a valid exercise of business judgement.[203] Once a

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[198] *Ibid.* 473 A.2d 805 at 814 (Del. S.C. 1984).

[199] Edward Welch & Andrew Turezyn, *supra* note 163 at 833.

[200] 480 A.2d 619 (Del. S.C. 1984).

[201] *Ibid.* 480 A.2d 619 at 624 (Del. S.C. 1984).

[202] Edward Welch & Andrew Turezyn, *supra* note 163 at 839.

[203] *Pogostin v. Rice,*480 A.2d 619 at 624 (Del. S.C. 1984).

reasonable doubt is shown as to both requirements, demand will be excused as being futile, unnecessary and merely procedural.

However the above test for demand futility laid down in *Aronson v. Lewis* is subject to some exceptions. It will not apply where (1) a business decision was made by the board of a company, but a majority of the directors making the decision have been replaced; (2) the subject of the derivative suit is not a business decision of the board; and (3) the decision being challenged was made by the board of a different corporation.[204]

At common law, demand was excused where the directors are so involved that it would be absurd to expect them to take action to redress the wrong, or if it could be shown that there had been a general meeting substantially approving of what had been done, or if it could be shown from the acts of the corporation as a corporation, distinguished from the mere acts of its directors, that the board had approved of what had been done, and had allowed a long time to elapse without interfering, so that the board did not intend and was not willing to sue.[205]

Most Canadian legal writers like Stanley Beck, Gordon Phillips and M. Maloney have proposed that under the Canadian corporation laws, notice to directors should be excused or dispensed with where it will be futile as is the position in America.[206] For example in *Gillespie*

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[204] *Rales v. Blasband,* 634 A.2d 927 at 933-934 (Del. S.C. 1993).

[205] See Jessel, M.R. in *Russell v. Wakefield Co.* (1875), L.R. 20 Eq 474 at 482.

[206] See Stanley M. Beck, "The Shareholders' Derivative Action" (1974) 52 Can. Bar Rev. 167 at 202; Gordon Phillips, *supra* note 38 at 386-390; M. Maloney, "Whither the Statutory Derivative Action?" (1986) 64 Can. Bar Rev. 309 at 323-324.

v. Overs; Tesari Holdings Ltd. v. Pizza Pizza Ltd.,[207] the court indicated that while there are cases where notice will be waived, however notice will not be regarded as futile where such will be due to the complainant's intransigence.

However, in Canada the futility exception has not been fully accepted in view of the clear provisions of the legislation. For instance, in *Re Daon Development Corp.*,[208] where an issue arose as to whether it would be futile to serve a notice on the directors. The applicant's counsel had contended that notice would be futile since the directors would not bring the desired action. Wallace, J.[209] had held that it would be an error to relieve the applicant of the obligation to comply with the requirements of the statute where the condition could be easily performed without undue expense or effort. Further that if notice had been given any suspected futility in making the request, if such exists, would be readily exposed. Finally he held that where there is a doubt as to the directors prosecuting, such can be easily resolved by an appropriate and timely request. Similarly in *Solomon v. Elkind*,[210] the court refused to comment on the extent of the application of futility requirement while recognizing that it would be futile to require the directors to act in the case.

It is however important to note that Gordon Phillips has identified five reasons in support of the position that the futility exception should not avail a complainant in Canada

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[207] Unreported, August 14, 1987, Ont. H.C., per Sutherland, J. Crt No.: RE 1088/87, RE 1115/87, at 69, summarized (1987), 5 A.C.W.S. (3d) 430.

[208] (1984), 54 B.C.L.R. 235 (S.C.).

[209] *Ibid.* at 241.

[210] (1976), 3 C.P.C. 31 (Ont. H.C.).

(and possibly Nigeria).[211] First, it is cheap, quick and simple to make a demand so as to avoid the problem of proving its futility.[212] Second, that the reasons for not making demand are not satisfactory. Third, that it would be too easy for shareholders to artificially invoke futility exception in every circumstance.[213] Fourth, that the aim of notice is to allow the directors to sue if they want to. And finally, that the exceptions to demand will grow inordinately complex as a result of the recognizing the futility rule.

It is proposed that the minority should be allowed to waive the notice requirement where the directors are patently interested in the challenged transaction, or are dominated by or are not independent of the wrongdoers, or where irreparable harm will be done to the corporation. The service of notice on these people will only help them to procastinate and delay the corporate remedy and the desired relief of the complainant.

It is thus proposed that the Canadian and Nigerian Corporation Acts should make express provisions for waiver of notice requirement where such will be futile or unnecessary, or will lead to a derogation from the underlying purpose of derivative actions. Canadian courts have accepted the applicability of the futility rule in Canada. For istance in *Gorner v.*

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[211] See Gordon Phillips, *supra* note 38 at 387-388.

[212] See *Starrels v. First National Bank Chicago*, 870 F.2d 1168 at 1173 (7th Cir. 1989) where the court noted that "...There is a steady flow of litigation about the demand requirement. Why this should occur is something of a mystery. Why should shareholders prefer costly litigation about the need for a demand to the cheap expedient of making one?"

[213] See *Lewis v. Graves,* 701 F.2d 245 at 249 (2d Cir. 1983), where it was held that "To construe it as sufficient would mean that the plaintiffs could readily circumvent the demand requirements merely by naming as defendants all members of the derivative corporation's board. Permitting plaintiffs to employ this tactic would eviscerate (the rule)."

Martin,[214] the court held that no notice was required where it will be futile to do so. A strict adherence to the notice requirement will create unnecessary delay, additional expense and waste of the corporation's resources. As was noted by Robert Clark:

> A possible reason for not following this suggestion is that demand creates delay and expense. When directors receive a demand they inveitably embark on a flurry of defensive maneuvers at corporate expense, and the plaintiff's lawsuit is at least delayed until a reasonable time for their response has passed. Accordingly, if the demand is truly futile-if a negative decision by the directors is quite likely to be made but not to preclude the suit-there is reason not to incur these costs.[215]

In summary, express provisions are required in the legislations excusing notice in appropriate cases. Even in Nigeria and Canada, where there is a refusal by the board to commence a legal action after service of notice, this will have no effect on the shareholder's standing to sue. The CAMA and ABCA only require giving of notice to the board, and refusal after notice will only butress the shareholder's claim that he should be granted leave as the board is not ready to act to enforce the company's rights. Dennis Peterson has submitted that the two most obvious ways in which refusal can be established is by (1) direct refusal and (2) passage of unreasonable and substantial period of time.[216]

In America, once a notice is served on the board to initiate an action against the wrongdoers, and the board refuses to commence a legal action, the shareholder may be allowed to sue. Where the claim is against an external third party, the shareholder will have a clear right to sue. But where the claim is against one of the corporation's directors and

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[214] (1985), 4 C.P.C. (2d) 72 (Nfld. T.D.); see also *Griesbach v. Majury*, Unreported, March 1, 1991, Ont. Gen Div. per Mossop, J. Ct. No.: 4032790.

[215] Robert Clark, *supra* note 59 at 645. See also Notes, "Demand on Directors and Shareholders as a Prerequisite to a Derivative Suit" (1959-60) 73 Harv. L. Rev. 746.

[216] Dennis Peterson, *supra* note 148 at para. 17.36. See generally Donald E. Pease, "*Aronson v. Lewis*: When Demand is Excused and Delaware's Business Judgement Rule" (1984) Del. J. of Corp. L. 39.

officers, the standard approach is that the shareholder must prove that the directors are personally involved or interested in the alleged wrongdoing in a way calculated to impair their exercise of business judgement on behalf of the corporation, or that their refusal to sue reflects bad faith or breach of trust. Thus where the majority of the board had participated in the wrongdoing or were dominated or controlled by the primary wrongdoers, the court will allow the minority to sue.[217]

c. Good Faith

While there is no clear definition of *good faith* in the statutes, the Lawrence Committee[218] had originally noted that the requirement was meant to discourage strike suits designed to provoke secret settlements with companies, a practice which was prevalent in America. To the Dickerson Committee,[219] the provision was meant to prevent "private vendettas" between shareholders. Sections 303(2)(c) of the CAMA and 232(2)(b) of the ABCA both require the complainant to be acting in good faith while seeking leave to prosecute the derivative action. While there is no express definition of "good faith" in the Acts, the full import of this requirement can be gleaned from case law.

In America, there was strong emphasis on the applicant to show that he has afforded the defendants all opportunity to remedy the wrong before taking the action, so as not to make the suit a retaliatory measure or unnecessary. For instance, in *Smith v. Chase &*

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[217] Robert Clark, *supra* note 59 at 644.

[218] *Interim Report of the Select Committee on Company Law, (the Lawrence Report)* (Toronto: Ontario Queen's Printer, 1967) at 63.

[219] *Proposals for a New Business Corporations Law for Canada, (the Dickerson Report)*, Vol. 1 (Ottawa: Information Canada, 1971) at 161 and at para. 482.

Baker,[220] the applicant demanded that the directors take steps to rectify the wrong that had occured, the board refused to act but requested the applicant to attend a meeting for further discussions on the matter. The applicant refused to attend the meeting, but decided to commence a derivative action which was dismissed for lack of good faith. In *Shlensky v. Dorsey*,[221] the court held that the applicant's letters to the board did not adequately inform them of the matter in dispute and so the directors did not have a fair opportunity to seek redress from the wrongdoers. The court held that "the complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authorities and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort."[222] In *Hawes v. Oakland*,[223] the claim was dismissed because the applicant commenced an action five days after making the demand on the board without giving them enough time to consider his request.

In the Canadian decision of *Vedova et.al. v. Garden House Inn Ltd.*,[224]Anderson, J. refused to grant the applicants leave as he was not persuaded that they were acting in good faith, because "..in my view they are motivated less by the potential return to the corporation

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[220] 197 F. 466 (E.D. Mich. 1912).

[221] 574 F. (2d) 131 (3d Cir. 1978).

[222] *Ibid.* per Maris, C.J. at 140.

[223] 104 U. S. 450 (1881).

[224] (1985), 29 B.L.R. 236 (Ont. H.C.).

than by the potential tactical advantage as against the respondents."[225] In *Appotive v. Computrex Centres Ltd.,*[226] Rae, J. held that the affidavit of the applicant's solicitor raised substantial issues to find him acting *bona fides* in the interest of the corporation.[227] Batten, J. in *Re Besenski; 8th Street Theatre Co. Ltd. v. Besenski,*[228] also held that because there was no affidavit before him to establish the applicant's good faith in suing derivatively, he would not grant the application.[229] The Ontario High Court in *Abraham v. Prosoccer Ltd.et.al.*[230] questioned the applicant's bona fides as follows:

> I question Maloney's *bona fides*. It is apparent to me that he seeks to acquire at no cost to himself the benefit of proceedings that have been paid for by others. Thousands of dollars have already been expended. His real object seems to me to be simply to obtain a better settlement for himself and others he purports to represent: i.e., more money. I doubt his alleged interest in having the issues tried; I would have been more impressed with the suggestion if he had had some grasp of those issues before he sought to intervene. [231]

Also in *Bennaroch v. City Resources (Can.) Ltd.,*[232] a director who was not a shareholder, through his solicitor, alleged that one of the directors had recieved bribe. Legg, J.A. quoted [233] the learned trial judge as having found that:

But what is damning on the issue of good faith is that it is obvious that Mr Bennaroch-who

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[225] *Ibid.* per Anderson, J. at 241.

[226] (1981), 16 B.L.R. 133 (B.C.S.C.).

[227] *Ibid.* per Rae, J. at 137.

[228] (1981), 15 Sask. R. 182 (Sask. Q.B.).

[229] *Ibid.* per Batten, J. at 185.

[230] (1980), 119 D.L.R. (3d) 167 (Ont. H.C.).

[231] *Ibid.* per Reid, J. at 171-172.

[232] (1991), 54 B.C.L.R. (2d) 373 (C.A.).

[233] *Ibid.* at 382.

> makes the allegation of bribery-was not interested in learning the relevant facts before forcing the issue....was not the least bit interested in a fair assessment of the situation after a decent opportunity for the presentation of the relevant facts....It is my conclusion that with respect to the allegation of bribery the respondents have demonstrated that the petitioner is 'bloody minded.' He is not the well intentioned, concerned director he would have me believe him to be.[234]

In *Bellman v. Western Approaches Ltd.,*[235] it was left open whether the submission of the defendants' counsel that there will be absence of good faith where the applicant claims the same reliefs for both personal and derivative actions was valid.[236]

To this writer while proof that the complainant is acting in good faith and in the corporation's best interest is required, the fact that he has a personal interest in the suit will not negate good faith.[237] It has been held that the mere likelihood that the applicant will derive a personal benefit is not an evidence of bad faith. In this same line, Tysoe, J. held in *Primex Inv. Ltd. v. Northwest Sports Ent. Ltd.*[238] that:

> I have no doubt that the Petitioner is acting out of self-interest in wanting to prosecute the derivative action. The self-interest is to maximize the value of its shares in Northwest by pursuing causes of action which [Northwest] may have...The Petitioner's self-interest coincides with the interests of Northwest. This does not mean the Petitioner is acting in bad faith...Anything that benefits a company will indirectly benefit its shareholders by increasing the share value and it is hard to imagine a situation where a shareholder will not have a self-interest in wanting the company to prosecute an action which is in its interests to prosecute.[239]

To this effect, Gordon Phillips is correct that *good faith* means that the applicant's

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[234] Legg, J.A. went to great length in quoting the opinion and findings of the trial judge to show that the applicant was acting out of bad faith.

[235] (1981), 33 B.C.L.R. 45 (B.C.C.A.).

[236] *Ibid.* per Nemetz, CJBC at 53.

[237] This view is supported by legal writers like Scott Turner, *supra* note 171 at 1.1.20.

[238] (1995) 13 B.C.L.R. 300 (B.C.S.C.).

[239] *Ibid.* at 313.

sole or dominant purpose in seeking leave is to obtain relief (generally monetary) for the company, though such relief will indirectly accrue to the applicant's benefit as a shareholder in the corporation.[240] In *International Capital Corporation v. Schafer*,[241] a former director against whom an action had been commenced by the corporation sought to bring an action for negligence against the corporation's solicitors. The court held that while the complainant's indirect financial interest will not amount to bad faith, he was trying to secure a tactical advantage in order to force a compromise of the action against him. Thus Bayton, J. held:

> The fact alone that the applicant has a personal interest in the outcome of the derivative action is not evidence of bad faith if that personal interest is related to or is not contrary to the interests of the corporation. But a personal interest in the derivative action that is unrelated to or is contrary to the interests of the corporation, is an indication of bad faith.[242]

In conclusion, perhaps the best working definition of *good faith* concept was that given by Mr Justice Puddester in *Tremblett v. S. C. B. Fisheries Ltd.* that:[243]

> ...the concept of good faith encompassed by the statutory requirements..relates to the intention of the applicant-whether the application is brought with the motive and intention of benefiting the corporation, or for some recognized or subliminal purpose or benefit outside that interest...[F]or statutory relief against the strict common law position of non-intervention in majority decisions internal to corporations, in light of the extraordinary power vested in a shareholder or director applicant to use the corporate resources and to create a position of legal conflict between the corporation and others, it is necessary that an applicant bring cogent evidence established clearly on a preponderance of evidence that the application is in fact brought in good faith.[244]

It is also important to refer to the *litmus test* established by Tysoe, J. in

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[240] See Gordon Phillips, *supra* note 38 at 391. He cited the case of : *Anderson v. Anderson* (Supreme Court, Toronto Weekly Court, May 15, 1978, unreported), where two enstranged children apparently motivated by their equally estranged mother sought leave, which was refused as being not made in good faith.

[241] (1997), 8 W.W.R. 412 (Sask. C.A.), *aff'g* (1997), 5 W.W.R. 80 (Q.B.).

[242] *Ibid.* per Bayton, J. (1997), 5 W.W.R. 80 (Q.B.) at 107.

[243] (1993), 116 Nfld & P.E.I.R. 139, at 151 (Nfld. S.C.).

[244] *Ibid.*

Intercontinental Precious Metals v. Cooke,[245] that:

> The matter of legal fees will, in a sense, be the litmus test for this proceeding. If the (petitioners) are prepared to prosecute the derivative action with the risk that they may not be reimbursed for the legal costs incurred by them, it will tend to substantiate their positions that they are acting in good faith and that they do believe the pursuit of the action is in the best interest of the company.[246]

From the above it is clear that the requirement of good faith is met where the applicant can show that he is seeking the action basically for the corporation's benefit and he is willing to afford the defendants all opportunity to clear the allegations raised before heading to court though he may have an indirect benefit in the prosecution of the suit.

d. Best Interest of the Corporation

The Dickerson Committe had included this requirement in order that the complainant should establish that the action is in the best interest of the corporation as it blocks actions to recover small amounts, particularly actions really instituted to harass and embarrass directors or officers who have committed an act which, although unwise, is not material.[247] The derivative action is meant to be prosecuted with corporate resources, and so must be in its interests as it will take some of the corporation's useful time, energy and resources. MacCarthy Tetrault has thus submitted that:

> [I]n determining the best interests of the corporation, courts look also to the reasons underlying a corporation's decision not to pursue the action and will consider whether, in deciding not to

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[245] [1993] 10 B.L.R. (2d) 203 (B.C.S.C.).

[246] *Ibid.* at 225.

[247] See *Proposals for a New Business Corporations Law for Canada, (the Dickerson Report)* Vol. 1 (Ottawa: Information Canada, 1971) at para. 482. See also F. A. Gevutz, "Who Represents the Corporation: In Search of a Better Method for Determining the Corporate Interest in Derivative Suits" (1984/85) U. of Pitt. L. Rev. 265.

assert a cause of action, the directors were acting impartially.[248]

While section 303(2)(d) of the CAMA requires the minority shareholder to satisfy the court that the action is in the best interest of the corporation, section 232(2)(c) of the ABCA only requires that the suit be in the interest of the corporation.[249] However, the term "best interest of the corporation shall be used mostly in this thesis. This requirement raises two issues. First, how much proof is required. Second, how would the court which party between the applicant and the board represents the corporation's best interests?

As to the first question of how much proof the applicant has to adduce to establish the best interests of the corporation, Nemetz, C.J.B.C. in *Bellman v. Western Approaches* [250] established the "arguable case" doctrine:

> In my view this is the key section for consideration in this case. The section does not say that the court must be satisfied that it is in the interests of the corporation. It says that no action may be brought unless the court is satisfied that it *appears* to be in the interests of the corporation to bring the suit. I take that to mean that what is sufficient at this stage is that an arguable case be shown to subsist. [251]

This *arguable case* interpretation has received support from Bruce Welling:

> The first is somewhat obvious. These are prerequisites for invoking judicial discretion. The action, if permitted to proceed, will presumably determine where the corporation's best interests lie. This cannot be determined in advance. Some of the statutes clarify the issue by noting that it must only appear *prima facie* to be in the corporation's best interest at this stage:...*Prima facie* means 'so far as can be judged from the first disclosure' indicating that the action should proceed if the shareholder has alleged sufficient facts which if true, would prove a breach of

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[248] MacCarthy Tetrault, *Directors' and Officers' Duties and Liabilities in Canada,* (Toronto: Butterworths, 1997) at 74.

[249] In the case of the ABCA, s. 232(2)(c) talks about "interest of the company" and also includes the best interests of the subsidiary corporation, the CAMA at s. 303(2)(d) specifies the "**best** interests of the corporation. However in this research we shall talk of the "corporation's best interests" at all times.

[250] (1982), 33 B.C.L.R. 45 (B.C.S.C.).

[251] *Ibid.* per Nemetz, CJBC at 53-54.

duty to the corporation which is likely to go unremedied unless the action is allowed to proceed.[252]

Under section 225(3)(c) BCCA, the word *prima facie* is expressly inserted in the statute and Cashman, L.J.S.C. in *Re NorthWest Forest Products Ltd.,*[253] interpreting this provision, held that presumably the authors of the legislation meant that a minority shareholder being in a real sense on the outside is often NOT in a position to obtain evidence such as that which the Crown would be expected to put forward to found a prima facie case in a criminal matter.[254] Thus he accepted the Jowitt's Dictionary of English Law and Black's Law Dictionary's definition of *prima facie* as "so far as can be judged from the first disclosure."[255]

Derivative actions being of equitable origin, cannot be interpreted to impose an onerous burden of proof on the applicant. This is supported by Gudmundseth and Draibye that, "once an arguable case is established courts will be unlikely to conclude that it is not in the best interests of the company that the action be pursued."[256] This position is also corroborated by the findings of Macdonald, J. in *Walter Heller v. Powell River Town Centre,*[257] that:

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[252] See Bruce Welling, *supra* note 145 at 529.

[253] [1975] 4 W.W.R. 724 (B.C.S.C.).

[254] *Ibid.* per Cashman, LJSC at 735.

[255] *Ibid.*

[256] See Gudmundseth & Draibye, *supra* note 157 at 3.1.10, para C.

[257] (1983), 49 B.C.L.R. 145 (B.C.S.C.).

> [T]here is sufficient evidence which on its face,[258] discloses the possibility that Barr availed himself of 'a maturing business opportunity' within the meaning of *Can. Aero Services*[259] *(decision)*"and so that it appears that a judgment in favour of the derivative corporation that another corporation holds the disputed property in trust for it would "obviously be in its interests."[260]

Perhaps the enumerated criteria proposed by the defendants in *Primex Inv. Ltd. v. Northwest Sport Ent. Ltd.,*[261] may be adopted as guidelines for determining the corporation's best interests. These include the following (1) whether the action is more likely to succeed than not; (2) whether the action will unduly disrupt the day-to-day operations of the company; (3) whether it will put at risk assets of the company; and (4) whether, if the action suceeds, any damages or substantial damages are likely to be awarded.

As to the second issue of determining who can best be taken to represent the corporation's best interests, it should be kept in mind that all the court is doing at this stage is to determine the desirability of the applicant to derivatively pursue the action, and not to conduct a full trial. The test proposed by Macdonald, J. in *Walter Heller v. Powell River T.C.*, [262] that once it appears that the award in the matter is being pursued solely for the corporation's benefit, that should suffice. This is more so, as Bruce Welling has pointed out, when the corporation is caught in a tug-of-war between a complaining minority and an entrenched board. Both the minority and the corporation are bound to lose, and unless the

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[258] See Macdonald, J. in *Walter Heller v. Powell River Town Centre* (1983), 49 B.C.L.R. 145 at 153-154 (S.C.).

[259] *Can. Aero Service Ltd. v. O'Malley,* [1974] 40 D.L.R. (3d) 371 (S.C.C.).

[260] (1983), 49 B. C. L. R. 145 at 153 per Macdonald, J. (S.C.).

[261] (1995), 13 B.C.L.R. (3d) 300 (S.C.) .

[262] *Ibid.*

court adopts a relaxed approach to the issue and gives the minority shareholder leave to prosecute the suit, the matter may not be heard. Thus once an arguable case has been shown to exist, the matter must be heard on its merits.[263]

In America, the use of independent litigation committees to determine whether it is in the corporation's interests that the action proceeds is very common. Thus Bruce Welling noted as follows:

> A common defensive tactic has developed in America to respond to shareholder attempts to bring actions on behalf of corporations. The board of directors of the corporation appoints a committee of the board (now commonly called a 'special litigation committee') and the committee reports on whether the action would be in the corporation's interests. Presumably, if the committee reports that it would, either the board would resolve to have the corporation sue, thus solving the shareholder's problem, or the report would disappear. If the report is negative it will be filed with the court as evidence against the proposed action.[264]

X. Exercise of the Court's Discretion

Where a complainant has given notice to the corporation's directors of his intention to sue derivatively and has been successful in proving that the proposed derivative action is being brought in good faith and is *prima facie* in the best interests of the corporation (and in Nigeria, that the directors are the wrongdoers who will not take necessary action), then the court has to exercise its discretion as to whether to grant leave or not.The granting of leave is discretionary, and the court has to exercise this power within some guidelines which are not expressly stated in the statutes. Perhaps the best approach to guide the exercise of the court's powers is that adopted by O'Leary, J. in *Re Marc-Jay Investments Inc. and Levy et.al.*[265]

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[263] See Bruce Welling, *supra* note 145 at 534.

[264] In this regard , see also Bruce Welling, *supra* note 145 at 530. This will be discussed in greater detail in Chapter 4.

[265] (1974), 5 O.R. (2d) 235 (Ont. H.C.).

After finding that the applicant has satisfied all the requirements, he held that the alleged fraudulent transaction involving the purchase of the corporation's shares is not the issue before him:

> It is not my function to decide whether such contemplated action will suceed at trial, but simply to decide whether there is *prima facie* merit to it...It further appears that the applicant is of the belief that Levy paid too much for Premium and the appellant points to some evidence in support of that belief....It is obvious that a Judge hearing an application for leave to commence an action, cannot try the action. I believe it is my function to deny the application if it appears that the intended action is frivolous or vexatious or is bound to be unsuccessful. Where the applicant is acting in good faith and otherwise has status to commence the action, and where the intended action does not appear frivolous or vexatious and could reasonably succeed; and where such action is in the interest of the shareholders, then leave to bring the action should be given....I am not to deny leave to bring an action simply because on a weighing of the evidence, I should decide it is unlikely that the action will be successful. I might say I have not reached any such conclusion in this case. I feel, therefore, that I must give the applicant leave to bring its intended action.[266]

Thus all that the court should do at this stage is to determine if there is *prima facie* merit to the applicant's case at first glance. However where the evidence disclosed by the applicant's motion and the defendant's counter motion do not support a meritorious claim, the court should not waste its time. For instance, in *Feld v. Glick,* where the plaintiff failed to obtain an order of court to sue for some derivative claims, Morden, J. held:

> For the reasons hereinafter set forth I have concluded that the merits are not so clearly and obviously in the defendants' favour with respect to this issue that it would be proper to dismiss the plaintiff's action such as this. It is unnecessary to refer to the many authorities to the effect that my jurisdiction on such a motion is to be exercised very sparingly. [267]

Notwithstanding the above, courts of equity and law should always be eager to adopt the flexible and less technical approach of O'Leary, J. as stated in *Re Marc-Jay Investments*

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[266] *Ibid.* per O'Leary, J. at 236-237.

[267] (1975), 8 O.R. (2d) 7 (Ont. H.C.).

and Levy.[268] as Cory, J. did in *Armstrong v. Gardner*,[269] when he held that contrary to the defendants' assertion that the applicant's action is premature:

> The Respondent argues that until a loss or injury has been demonstrated, the action ought not to be permitted to proceed. It is said that the action is frivolous in the sense that it is premature and ought not to be encouraged or permitted by the Court. In my opinion, the facts are overwhelming in their support of the applicant's position. The test by which I should be governed in such applications has been laid down in the decision of O'Leary, J., in *Re Marc-Jay Investments Inc. and Levy et al*...It is clear I am not to try the action on the hearing of this application. Rather, if I come to the conclusion that the applicant is acting in good faith, has complied with the requirements of s.99,[270] that the action does not appear to be frivolous or vexatious and could reasonably suceed and that it is in the interests of the shareholders, then leave to bring the action should be granted.[271]

The courts should always bear it in mind that they are not trying the action, but are only considering whether to allow the legitimate claims of the corporation, as asserted by a private litigator, to be heard on the merits. The matter may in the long run be decided either way. Thus where leave is granted, this is not an absolute guarantee that the minority shareholder's action would succeed. The directors can still defend on other grounds, as all the defences available to the corporation can be asserted and maintained by them. All that the court should do at this stage is to give the matter a chance to be heard in an open court and in doing this Nigerian courts should follow the relaxed Canadian approach of Justice O'Leary.

XI. Obstacles to the Effective Use of Statutory Derivative Actions

Since the coming into effect of the statutory derivative actions in Canada and Nigeria,

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[268] (1974), 5 O.R. (2d) 235 (Ont. H.C.).

[269] (1978), 20 O.R. (2d) 648 (Ont. H.C.).

[270] Of the original OBCA, now replaced by s. 246 OBCA, R.S.O.1990 c. B. 16.

[271] See Cory, J. in *Armstrong v. Gardner* (1978), 20 O.R. (2d) 648 at 652-653 (Ont. H.C.).

the question that has bothered legal scholars is whether the statutory reforms have met their desired aims, in this regard perhaps the chief competitor to the derivative action provisions is the oppression remedy.[272] While the statutory derivative actions have removed the rigidity and uncertainty surrounding the common law majority rule, it has not achieved corporate equality and justice for the following reasons:

a. Intricate Procedural Steps

Unlike the relief based on oppression, the minority shareholder's ability to use the derivative procedure is predicated on being able to satisfy the requirements of falling within the defined category of complainants, service of adequate notice, acting in good faith and proving that the suit is in the corporation's best interests. However these requirements are not necessary for commencing an action based on oppression. According to MacCarthy Tetrault:

> Use of the derivative action may also be inhibited by the complexities involved in mounting a derivative action, resulting from the special role played by the court in administering the suit. The emergence of the oppression remedy, which imposes little in the way of procedural requirements or other impediments to sustaining an action, may also account for the declining use of the derivative action as a remedy for management abuse.[273]

b. Likelihood of Benefiting from the Court's Award

The recovery from a derivative suit is ordinarily awarded to the corporation and not to the individual. Unlike the personal and oppressive actions where recoveries accrue to the individual or class of shareholders, all the proceeds of a derivative action are often for the

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[272] See generally G. Shapira, "Minority Shareholders' Protection-Recent Developments" (1983) 10 New Zealand L. Rev. 134. See also CAMA ss 310 & 311; ABCA s. 234. A more detailed comparison of the derivative action and an action for relief based on oppression is carried out in Chapter 5 of this work.

[273] MacCarthy Tetrault, *supra* note 248 at 75; See also George D. Hornstein, "New Aspects of Stockholders' Derivative Suits" (1943) 47 Colum. L. Rev. 1.

corporation, which may yield little or no benefit to a small shareholder. According to Scott Turner:

> The difficulty, from minority shareholder's perspective, in pursuing a derivative action, is that it results only indirectly in a recovery for that shareholder. Thus, if the company is sucessful, the company will recover a judgment, not the shareholder who has initiated and perhaps controlled the derivative proceedings resulting in that recovery. The shareholder benefits, of course, indirectly by the enrichment of the company, but that enrichment may not be reflected in a corresponding increase in the value of the shareholder's shares, or by the issue of dividends..it is for this reason that personal or oppression actions may be more attractive to a minority shareholder.[274]

However, there are instances where the court may order that the proceeds be paid directly to the shareholders in order not to allow a wrongdoing director to profit from his own wrong, more so where a former security holder was divested of his shares in the corporation as a result of the directors wrongful conduct.[275]

c. Funding of the Suit

Although the subject of funding of the derivative action is considered elsewhere in detail in this paper, it is important to point out that one of the problems facing the minority shareholder in commencing a derivative suit is that he may be required to fund the suit until conclusion subject to certain exceptional situations when the court may make either an interim or final funding order. The prospect of single handedly funding the suit, entails a lot of courage and patience which may deter an average shareholder.

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[274] Scott Turner, *supra* note 171 at 1.1.03. Under the New York *Business Corporation Law,*the court will not award damages or attorney's fees to the minority shareholder, because generally, the shareholder is not entitled to recover reasonable attorney's fees, however this sum is usually deducted from the award to the corporation since it was the shareholder's efforts that allowed for the recovery in the first place. In particular see George D. Hornstein, "Problems of Procedure in Stockholder's Derivative Suits" (1942) 42 Colum. L. Rev. 574.

[275] This is permitted under the various wide discretionary powers which the business corporation laws conferred on the court in achieving substantial justice based on the circumstances of each case and this will be discussed later in Chapter 6.

d. Access to Corporate Facts

Although the individual minority shareholder is nominally representing the corporation in the suit, the management of the company and the basic corporate information remains with the defendants, and unless the minority shareholder gets a discretionary court order compelling his unrestricted access to corporate information, the smooth and efficient prosecution of the suit may be frustrated on claims of privilege.

The above represent the few identifiable problems that are to be addressed by Companies Acts in ensuring that minority derivative rights are not only clearly stated but also effective for his protection. However the impugned directors are totally defenceless in the prosecution of the derivative suit. There are various grounds for them to challenge the suit. The defences open to the board both procedural and substantive are the subject for consideration in the next chapter.

CHAPTER 4

THE BOARD AND MAJORITY'S DEFENCES TO A DERIVATIVE ACTION

I. Introduction

This chapter will critically examine the instances wherein the court may refuse leave to the shareholder in bringing the derivative suit on grounds of law, equity or procedure. More particularly, after the shareholder had complied with all the statutory requirements of control by the directors or the majority, service of adequate notice, good faith, and that the action is in the corporation's best interests. We shall examine the scope of the Business Judgement Rule and the role and powers of the Special Independent Litigation Committee of the board in the light of decided cases over the years as is operative in America.[1]

At common law, Knox, J. in *Smith v. Croft (No 2),*[2] had held that where an independent organ of the company does not approve of the minority shareholder's derivative

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[1] For a detailed history and scope of the business judgement rule and the powers of the Special Independent Litigation Committee under the American business corporations laws, see generally Richard C. Brown, "Shareholders Derivative Litigation and the Special Litigation Committee" (1981-82) 43 U. of Pitt. L. Rev. 601; John C. Coffee, Jr. & Donald E. Schwartz, "The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform" (1981) 81 Colum. L. Rev. 261; George W. Dent, Jr., "The Power of Directors to Terminate Shareholders Litigation:The Death of The Derivative Suit" (1980-81) 75 Nw. U. L. Rev. 96; Notes, "Demand on Directors and Shareholders as a Prerequisite to a Derivative Suit" (1959-60) 73 Harv. L. Rev. 746; John S.Martel & Charles M. Sink, "The Derivative Action: Is There Life After Lasker?" in J.S.Martel, ed., *The Investor And The Corporation:New Developments And Tactics in Stockholder Litigation* (New York: Practising Law Insitute, 1980) at 197; Stanley Nemser, "Derivative Actions" in Stuart D. Weschler, ed., *New Directions in Securities Litigation* (New York: Practising Law Institute, 1976) at 67; Donald E. Pease,"*Aronson v Lewis*: When Demand is Excused and Delaware's Business Judgement Rule" (1984) 9 Del. J. of Corp. L. 39; Gordon Phillips, *Personal Remedies for Corporate Injuries* (Scarborough: Carswell, 1992) at 395; Neil C. Rifkind, "Should Uninformed Shareholders Be A Threat Justifying Defensive Action By Target Directors In Delaware?: Just Say No After *Moore v. Wallace*" (1998) 78 Boston U. L.Rev. (No.1) at 105; Richard G.Ritchie, "Derivative Actions" in Stuart D.Weschler, ed., *New Directions in Securities Legislation* (New York: Practising law Institute, 1976) at 91; Robert Clark, *Corporate Law* (Boston: Little, Brown & Co.,1986) at 645-649; Edward P. Welch & Andrew J. Turezyn, *Folk on the Delaware General Corporation Law: Fundamentals,* 1998 ed., (New York: Aspen Law & Business, 1998) at 851-858.

[2] [1987] 3 All E.R. 909 (Ch. D.).

action then the court will not allow the action to proceed. Similarly, the British Law Commission's report on the reform of company law[3] recognized certain situations when the shareholders derivative rights may be restricted, and these were labelled "Restrictions on Members' Ability to Bring Actions on Behalf of the Company."[4] The universal recognition of the limitations and restrictions on the derivative rights of the shareholder had resulted in some identifiable categories.This chapter will discuss in detail those occasions when the court will deny the shareholder his right to sue derivatively.

II. Ratification

At common law, where the board's wrongful conduct does not amount to fraud or an *ultra vires* act, the court may permit the ratification of the wrongful act once it is approved by the board or the majority shareholders at the general meeting. This is notwithstanding the fact that the guilty person may be voting at the general meeting. For example in *North-West Transportation Co. Ltd. v. Beatty,*[5] the Privy Council held that a sale of a ship to the corporation by its director was binding on it on ratification.[6]

Both the CAMA and the ABCA have abrogated the old common law rule which makes the board's ratification of the wrongful act or the abuse of corporate powers by the majority and/or the corporate managers an effective bar to the minority shareholder to

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[3] See *The Law Reform Commission (British):Shareholder Remedies, A Consultation Paper (Consultation Paper No.142.)*(London: Stationery Office, 1996).

[4] *Ibid.* See particularly Part 5 at 41-47. See also Notes, "Defenses in Shareholder Derivative Suits-Who May Raise Them?" (1952) 66 Harv. L. Rev. 342.

[5] (1887), 12 App. Cas. 589 (P.C.).

[6] See also *Regal (Hastings) Ltd. v. Gulliver,* [1967] v. Gulliver, [1967] 2 A.C. 134n.

commence a derivative action.[7] Sections 305 and 235(1) of the CAMA and ABCA respectively provide that a minority shareholder's derivative action shall not be stayed or dismissed by the shareholders of the corporation via ratification or approval, but evidence of such approval or ratification will be taken into account by the court in making an order under sections 304 and 233 of the CAMA and ABCA respectively.[8] To the Dickerson Committee, the reason for inserting this into section 242 of the CBCA was that such act of ratification should only be of evidentary value. The Dickerson Report states that:

> [r]ather than set out a specific rule declaring how an act of the directors may be ratified, we think it better to characterize shareholder ratification or waiver as an evidentiary issue, which in effect compels the court to go behind the constitutional structure of the corporation and examine the real issues. If, for example, the alleged misconduct was ratified by majority shareholders who were also the directors whose conduct is attacked, evidence of shareholder ratification would carry little or no weight. If, however, the alleged misconduct was ratified by a majority of disinterested shareholders after full disclosure of the facts, that evidence would carry much more weight indicating that the majority of disinterested shareholders condoned the act or dismissed it as a mere error of business judgement.[9]

Even at common law corporate acts that are *ultra vires* the company's memorandum can not be ratified by an ordinary resolution of the board.[10] As to the weight that the court

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[7] See F. H. Buckley, "Ratification and the Derivative Action Under the Ontario Business Corporations Act" (1976) 22 McGill L. J. 167.

[8] Similarly under the BCCA, section 225(7) provides that:

> No application made or an action brought or defended under this section shall be stayed or dismissed by reason only that it is shown that an alleged breach of a right, duty or obligation, owed to the company, has been or **might be approved** by the members of that company; but evidence of that approval or **possible approval** may be taken into account by the court in making an order under this section

Though this allowance for possible approval under the BCCA, is wider than the position under both the CAMA and ABCA, but in practice may not carry more weight than the provisions in the former Acts.

[9] *Proposals For a New Business Corporations Law For Canada,(the Dickerson Report)*, Vol. 1 (Ottawa: Information Canada, 1971) at para. 487.

[10] See *The Law Reform Commission (British), Shareholder Remedies, A Consultation Paper (Consultation Paper No. 142)* (London: Stationery Office, 1996) at 42; See also H. Mason, "Ratification of the Directors' Acts: An Anglo Australian Comparison" (1978) 41 Mod. L. Rev. 161.

will attach to resolutions ratifying the breach of directors duties. For instance in *Winthrop Investments Ltd. v. Winns Ltd.,*[11] it was noted that ascertaining the independence of other shareholders towards ratifying the breach of duty may not be a clear cut case.

The modern approach is to hold such shareholders'approval or potential approval at arm's length while the court goes behind the corporate resolution to find out the actual state of facts and events at the general meeting where the ratification was passed. While the evidentiary value of the shareholders approval will be very high where such approval was given by an independent and disinterested board of directors or shareholders general meeting. Likewise, the court will accord little or no significance to an approval given by an interested or dominated board, and so it has also been rightly noted that ratification cannot be taken into account in all cases.[12]

An example of how the court will regard an approval by the shareholders under the CAMA and ABCA was shown in *Re Northwest Forest Products Ltd.,*[13] where the complainant's motion to commence a derivative action to recover the corporation's property sold at a very low value was earlier on rejected at the shareholders general meeting. While it was true that the erring directors did not hold majority shares in the corporation so that it was not clear whether they dominated the general meeting, at the same time there was no evidence before the court as to how many shareholders voted for and against, or how the shares were represented at the meeting. The court found out that it was not clear whether the

[11] (1975), 2 N.S.W.L.R. 666 (Aus. H.C.).

[12] Gordon Phillips, *Personal Remedies for Corporate Injuries,* (Scarborough: Carswell, 1992) at 400.

[13] [1975] 4 W.W.R. 724 (B.C.S.C.).

complainant's motion had been defeated by a majority of disinterested and independent shareholders. Accordingly Cashman, L.J.S.C. rejected the minutes of the general meeting where the approval was given, and granted the complainant leave to sue derivatively by holding that:

> At the meeting held pursuant to that requisition that the motion was defeated....[T]his is a factor that 'may' be taken into account by the Court....On the other hand no minutes have been produced to indicate how many shareholders or how many shares were represented at that meeting....There is no evidence as to who voted those shares or indeed whether any shares were voted by proxy.[14]

It would appear that the board has the onus to prove that the approval was given by a disinterested and independent general meeting so that the court may give significant evidentiary weight to the approval or ratification.[15]

III. Inequitable Conduct of The Complainant[16]

The derivative right of the shareholder is grounded in equity and the concept of trust, under which the corporate managers are seen as trustees of the shareholders (beneficiaries) capital and wealth.[17] Thus where there is a breach of trust by the directors, and the shareholder wishes to sue derivatively, then he must come with clean hands, for he who

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[14] *Ibid.* per Cashman, L.J.S.C. at 733.

[15] See Stein Gudmundseth & Sandra Draibye, "Derivative Actions" in Gordon Phillips, ed., *Remedies for Corporate Injuries* (Vancouver: The Continuing Legal Education, 1993) at 3.1.03.

[16] A shareholder could be personally disqualified from bringing an action against the will of the majority if he participated or acquiesced in the acts he impeached. See *Henderson v. Strang* (1920), 60 S.C.R. 201; *Fullerton v. Crawford* (1919), 59 S.C.R. 314; *Griffin v. Baker* (1923), 24 O.W.N. 367; *Shiesel v. Kirsch* (1930), 66 O.L.R. 41 (C. A.); *Fisher v. Saint John Opera House Co.* (1937), 4 D.L.R. 337 (N.B.C.A.).

[17] See the previous discussion of the history of derivative actions in Chapter 3 of this paper; see also Bert S. Prunty, Jr., "The Shareholders' Derivative Suit: Notes on its Derivation" (1957) 32 N. Y. U. L. Rev. 980.

comes to equity must come with clean hands.[18] Equity requires that the complainant who seeks to sue derivatively must show that his past conduct regarding the impugned transaction had been fair, honest, and above board. Thus in *Towers v. African Tug Co.*,[19] the court held that the shareholder could not sue because he himself had participated in the wrongful conduct, by receiving the proceeds of the alleged *ultra vires* transaction. Further in *Nurcombe v. Nurcombe,*[20] the shareholder had collected a lump-sum settlement on divorce which had made allowance for some misappropriated funds belonging to the corporation.The court held that his conduct had come short of a fit complainant and as such is, according to Browne-Wilkinson, L.J.:

> ...[A] behaviour by the minority shareholder, which, in the eyes of equity,would render it unjust to allow a claim brought by the company at his insistence to suceed.[21]

The underlying fact here is that equity requires the shareholder to represent the injured corporation very adequately, and a tainted member cannot perform this role.[22] Under Rule 23.1 of the United States of America *Federal Rules of Civil Procedure*,[23] there is an equivalent requirement of adequacy of representation. In *Bartles v. Newirth,*[24] a shareholder who has participated in the wrong was held to lack locus standi. Similarly in *Courtland*

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[18] See Justice Louis Brandeis in *Loughran v. Loughran,* 292 U.S. 216 at 219 (1934); *Gill v. Lewis* (1956), 2 Q.B. 1 at 13-17 (Q. B.).

[19] [1904] 1 Ch. 558 (Ch. D.).

[20] (1985), 1 W.L.R. 370 (C.A.).

[21] *Ibid.* per Browne-Wilkinson, L.J. at 378.

[22] See also *Barrett v. Duckett* (1995), 1 B.C.L.C. 243.

[23] As amended, (1993).

[24] CCH Fed. Sec. L. Rep. * 95 .718 (S.D.N.Y. 1976).

Manor, Inc. v. Leeds,[25] three directors acquired substantially all the shares worth $90,000 in a company for $19,000. They also purported to sue another shareholder for executing an unfair contract in which he stood to benefit from. The court refused them relief on the ground that the shareholders from whom they bought their shares had participated and acquiesced in the wrong complained of. In *Hardy v. Hardy on Behalf of Mortg. Inv.,*[26] the court held that it could bar a derivative action on the ground that the shareholder had failed to carry out her corporate responsibilities and had paticipated in or consented to the wrong alleged.

IV. Availability of other Adequate and Specific Remedies

The CAMA and ABCA contain exhaustive provisions for the protection of the minority shareholder and for guaranteeing his access to the courts, and these in addition to derivative rights are the compliance or restraining order,[27] relief on the ground of oppression and unfairness,[28] and the appraisal right.[29] Each of these is meant to take care of specific situations. A dissenting shareholder in a corporate re-organization may wish that his shares be bought by the corporation at a fair market value or a judicially determined price, and in such a situation the most appropriate remedy for him is the appraisal remedy under section 184 of the ABCA. If such a shareholder applies for leave to commence a derivative action, the court will most certainly dismiss the suit without prejudice to his coming before the court

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[25] 347 A.2d 144 (Del. Ch. 1975).

[26] 507 So.2d 404 (Ala. 1987).

[27] See ABCA s. 240.

[28] See CAMA s. 311 & ABCA s. 234.

[29] See CAMA s. 608; ABCA s. 184.

under a proper heading later.[30] In the Scottish case of *Barrett v. Duckett,*[31] Gibson, L.J. noted that if another adequate remedy is available, the court will not allow the derivative action.[32] Furthermore in *Re Loeb and Provigo Inc.et al.*,[33] Steele, J. held:

> [I]f the application is to restrain any merger of the Company with Provigo in a corporate sense, this is dealt with specifically by statute and there is no cause of action as such by one party to such possible merger against the other...In addition I cannot see how such an action could possibly be one contemplated to be a representative action...(which) contemplates that the action will be on behalf of the Company to enforce a right, duty or obligation owed to the Company.[34]

V. The Corporation In Liquidation

That the derivative action is mainly to enforce corporate duties owed by the directors of the corporation was recognized by the British Law Commission on the Reform of Company Law. Where a company has gone into liquidation, there is no need for such a device as the liquidator, an independent third party, would have taken control of the company's affairs from the alleged wrongdoers. If there is a reasonable cause of action against the wrongdoers, the liquidator can cause the company to bring an action. In effect, the shareholder will lose the right to commence a derivative action once the corporation is being liquidated. All the rights in the corporation will be vested in the liquidator and the statutes

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[30] See generally Bruce Welling, *Corporate Law In Canada: The Governing Principles,* 2nd ed., (Toronto: Butterworths, 1991) at 537-538. On the nature of the appraisal rights under modern legislations see J. E. Magnet, "Shareholders' Appraisal Rights in Canada" (1979) 11 Ottawa L. Rev. 100.

[31] (1995), 1 B.C.L.C. 243.

[32] *Ibid.* at 250.

[33] (1978), 20 O.R. (2d) 497 (Ont. H.C.).

[34] *Ibid.* per Steele, J. at 499-501.

have made various provisions for dealing with wrongs occuring during liquidation.[35] Similarly, section 506 of the CAMA provides that if in the course of winding up there has been fraudulent trading, the official receiver, or the liquidator, or any creditor may bring an application to the court against such persons.

VI. Complainant's Claim not Clearly Defined or Distinguished from other Claims

The court on procedural grounds, may also not grant leave to a complainant who despite having satisfied all the statutory requirements, has pleaded the claims on the writ to include intermingled personal claims, class or representative claims, and the corporation's legitimate claims. This is purely a procedural device, and the complainant has the duty to specify his claim as clearly as possible and so distinguish them from each other,[36] and thus Bruce Welling noted that:

> ...cases in which judicial permission to proceed ought to be refused despite the prerequisites being satisfied, is a slightly more complex one. A given incident may give rise to legal claims by more than one plaintiff. This is true in any area of law. In corporate law, a wrong may cause injury, meaning compensable legal harm, to one or more shareholders and also to the corporation itself. A single shareholder may sue to redress the legal wrong to himself....No corporate law rules are involved here, though certain rules of civil procedure must be followed.....In a relatively unusual, though hardly rare.....A shareholder may seek to sue on his own behalf, bring a class action on behalf of his fellow shareholders with undifferentiated claims, join to that a representative action on behalf of shareholders with differentiated claims and, finally, seek judicial permission to join with those a [derivative] action on behalf of the differentiated claim of the corporation itself....It is the responsibility of the plaintiff to adequately differentiate these various claims so that those opposing his action can efficiently group and explain their objections for judicial comprehension. Where the plaintiff seeking to bring a statutory (derivative) action on behalf of a corporation has failed to be sufficiently clear in his statement of claim, permission to proceed under the section should be, and has been,

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[35] See for example s. 71(2) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3; In the case of Receivership, see also s. 96 of the CBCA, R. S. C. 1985, c. C-44; see also *The Law Reform Commission (British): Shareholder Remedies, A Consultation Paper (Consultation Paper No. 142)* (London: Stationery Office, 1996) at 47 and at para 5.20.

[36] See generally B. Welling, W. B. Rayner, C. Jordan & L. Smith, eds., *Canadian Corporate Law: Cases, Notes and Materials* (Toronto: Butterworths, 1996) at 363-370.

refused.[37]

It has been argued that there are grey areas between derivative and personal (class or individual) rights of the shareholders and that care should be taken to avoid pleading a claim as personal when it is actually derivative, and vice versa.[38] This was evident in *Hoskin v. Price Waterhouse Ltd.*,[39] where the complainant's action was dimissed because of insufficient characterization of the claims. Similarly in *Farnham v. Fingold et. al.*,[40] the Ontario Court of Appeal on an application by the defendants to dismiss the plaintiff's claims as disclosing no reasonable cause of action, held that the plaintiff's claims cannot be totally classified as a class action, and thus held that:

> [C]ertain parts of the statement of claim and in particular all or parts of paras. 22...are concerned with rights, duties or obligations owed to the defendant Slater Steel Industries Limited or with damage allegedly suffered by that corporation as a result of the actions of the other defendants. Such matters are properly the subject of a derivative action rather than a class action.[41]

After identifying some claims as derivative, the court went on to dismiss the action since no leave was earlier obtained amongst other reasons.[42] Also in *Goldex Mines Ltd. v. Revill*,[43] the court underscored the necessity of carefully drawing up the writ and statement

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[37] Bruce Welling, *supra* note 30 at 538-539.

[38] See Stanley Nemser, "Derivative Actions" in Stuart D.Weschler, ed., *New Directions in Securities Litigation* (New York: Practising Law Institute, 1976) 70.

[39] (1982), 136 D.L.R. (3d) 533 (Ont. H.C.).

[40] [1973] 2 O. R. 132, 33 D.L.R. (3d) 156 (Ont. C.A.); *rev'g* on other grounds [1972] 3 O.R. 688 (Ont. H.C.).

[41] *Ibid.* per Jessup, J.A. [1973], 33 D.L.R. (3d) 156 at 158-159 (Ont. C.A.).

[42] *Ibid.* see the orders of Jessup, J.A. 33 D.L.R. (3d) 156 at 161-162 (Ont. C.A.).

[43] [1973] 3 O. R. 869 (Ont. Div. Ct.); [1973] 1 O. R. 659; *aff'd* in (1974), 7 O.R. (2d) 216; 54 D.L.R. (3d) 672 (Ont. C.A.).

of claim:

> The trouble with endorsement is that it disclosed no attempt to differentiate between claims personal to shareholders and claims which are derivative. As already indicated, the subclauses of claims E and G intermingle 'grounds' that are clearly derivative in nature with some that are not. We do not think it is our function to suggest a redraft of the endorsement so as to bring it into conformity with the principles enunciated herein...We have concluded that the facts set out in the material would support an endorsement making some claims for relief that are personal and are not derivative, if properly pleaded, but they are inextricably woven into the derivative claims, in the present endorsement.[44]

VII. The Board's Special Independent Litigation Committee's Business Decision

The concept of "Special Litigation Committee" has its origin in the United States of America, where the board, on notice of the shareholder's complaint concerning the corporate wrong, may set up a special independent litigation committee ("the committee") of disinterested and independent directors with the corporation's counsel to advise the board on the propriety of the proposed action. Where the committee decides that it is in the interest of the corporation that the action be taken, then the corporation "might" sue. But where it is decided that the action is not in the best interests of the corporation, then the action is abandoned and where the shareholder has initiated the action in court already, the committee can move that the action be dismissed.[45] As to the efficacy of the use of the committee where the shareholder has not yet instituted an action before the court, Bruce Welling has noted:

> A common defensive tactic has developed in America to respond to shareholder attempts to bring actions on behalf of corporations. The board of directors of the corporation appoints a committee of the board (now commonly called a 'special litigation committee') and the

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[44] *Ibid.* [1974] 7 O.R. (2d) 216 at 226 (Ont. C.A.).

[45] For a detailed information about the Special Independent Litigation Committees, see the various articles and legal textbooks in note 1, *supra;* According to Ernest L. Folk, III, in *The Delaware General Corporation Law* (Boston: Little, Brown & Co., 1972) at 75: "the controlling principle is that the substance of a business decision or transaction made by a corporation's board of directors will not be reviewed or scrutinized by a court so long as 'the acts of the directors objected to were performed in good faith, in the exercise of their best judgement, and for what they believed to be the advantage of the corporation and all its stockholders.'"

> committee reports on whether the action would be in the corporation's interests. Presumably, if the committee reports that it would, either the board would resolve to have the corporation sue, thus solving the shareholder's problem, or the report would disappear. If the report is negative it will be filed with the court as evidence against the proposed action.[46]

In *Smith v. Croft (No. 2),*[47] Knox, J. recognized the applicability of this rule under the English common law, when he held that:

> Finally on this aspect of the matter I remain unconvinced that a just result is achieved by a single minority shareholder having the right to involve a company in an action for recovery of compensation for the company if all other minority shareholders are for disinterested reasons satisfied that the proceedings will be productive of more harm than good....I therefore conclude that it is proper to have regard to the views of independent shareholders.[48]

Where the shareholder's action is already before the court, upon notice to the board of the suit, the committee is composed by the board to look into the merits of the action. The committee, as usually the case, may then bring a pre-trial motion that the court should dismiss the action, as it is unmeritorious and not in the best interests of the corporation. Considering the pre-trial motion, Welch and Turezyn noted that:

> ...an independent committee may be appointed to investigate the allegations of wrongdoings against the corporation as contained in the complaint. After a thorough and objective investigation, the committee may cause the corporation to file a pretrial motion to dismiss the derivative suit. The basis for the motion is the best interests of the corporation, as determined by the committee. The motion must be supported by a thorough written record, which must delineate the investigation by the committee, the findings of the committee and the committee's recommendation.[49]

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[46] See Bruce Welling, *supra* note 30 at 530; see also Robert Clark, *Corporate Law* (Boston: Little, Brown & Co., 1986), at 645 where he observed that following the composition of the committee by the board, "The committee would then examine records, conduct interviews, hold meetings, write discussion drafts, and eventually, after a suitable display of investigative activity and collective deliberation, would produce a report that concluded, unsurprisingly, that the committee thought it was in the corporation's *best interest* not to proceed with the lawsuit. The corporation would then bring a motion to dismiss the lawsuit."

[47] [1987] 3 All E.R. 909 (Ch. D.).

[48] *Ibid.* per Knox, J. at 957.

[49] Edward P. Welch & Andrew J. Turezyn, *Folk on the Delaware General Corporation Law: Fundamentals,* 1998 ed., (New York: Aspen Law & Business, 1998), at 852-853.

To the courts, the nature of the committee's pre-trial motion for dismissal is:

> a hybrid one, derived by analogy to a motion to dismiss a derivative suit based on a voluntary settlement reached between the parties and to a motion brought....whereby a plaintiff unilaterally seeks a voluntary dismissal of the complaint subsequent to the filing of an answer by the defendant. As such, it is addressed necessarily to the reasonableness of dismissing the complaint prior to trial without adjudicating the merits of the cause of action itself.[50]

The court is then faced with two issues in assessing the motion of the committee. First, it determines whether the committee has the power to dismiss or request a dismissal, in which case, the court should pay deference to the committee's business decision. Second, the court has to determine what the scope of the judicial review of the special committee's recommendation will be.[51]

On the scope of the committee's power, historically the power of the board to use the committee to decide whether or not to bring a suit or request a dismissal by the court can be traced back to Justice Brandeis' dictum in *United Copper Securities Co. v. Amalgamated Copper Co.*:[52]

> Whether or not a corporation shall seek to enforce in the courts a cause of action for damages is, like other questions, ordinarily a matter of internal management, and is left to the discretion of the directors, in the absence of instruction by vote of the stockholders. Courts interfere seldom to control such discretion intra vires the corporation, except where the directors are guilty of misconduct equivalent to a breach of trust, or where they stand in a dual relation which prevents an unprejudiced exercise of judgement.[53]

The committee is usually composed of directors having no financial interest in the impugned transaction and who are not named as defendants in the action, or new directors

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[50] *Kaplan v. Wyatt,* 484 A.2d 501 at 506-507 (Del. Ch. 1984), *aff'd* 499 A.2d 1184 (Del. S.C. 1985).

[51] Robert Clark, *supra* note 46 at 646.

[52] 244 U.S. 261 (1917).

[53] *Ibid.* per Justice Louis Brandeis at 263-264.

who joined the corporation after the wrongful act, and/or outside directors along with the corporation's general counsel.

Generally, the board has the power to delegate the power to commence corporate litigation (which is a natural aspect of the general managerial powers conferred on the board under most modern corporation statutes) to the committee, and once the board has effectively and legally delegated its litigation powers to the committee, then any decision reached by the committee is a business judgement decision binding the board and the company. According to Sarah Stegemoeller, this delineates the role which the court will play in disputes between the shareholders and the directors over corporate management decisions and so, a court confronted with a challenged business decision will normally defer to the directors judgement in the absence of a clear showing of serious misconduct.[54] Generally, the court is apt to respect the business decision of the board, thus in *Warshaw v. Calhoun*,[55] it was held that:

> In the absence of bad faith on the part of the directors or a gross abuse of discretion the business judgement of directors will not be interfered with by the courts. The burden of showing the existence of bad faith or abuse of discretion rests upon the plaintiff who charges that the corporate action was taken to benefit the majority at the expense of the minority. The acts of the directors are presumptively acts taken in good faith and inspired for the best interests of the corporation, and a minority stockholder who challenges their *bona fides* of purpose has the burden of proof.[56]

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[54] See Sarah M. Stegemoeller, "Derivative Actions and the Business Judgement Rule: Directoral Power to Compel Dismissal" (1980-81) 69 Ill. B. J. at 338-339.

[55] 221 A.2d 487 (Del. S.C. 1966); see also *Smith v. Van Gorkom*, 488 A.2d 858 (Del. S.C. 1985) where it was held that absent intentional misconduct, illegality and improper benefit, the courts will not hold the directors liable for mere errors of judgement. They are presumed, in making business decisions, to have acted on an informed basis, in good faith and in the honest belief that their action was in the best interest of the company.

[56] *Warshaw v. Calhoun*, 221 A.2d 487 at 492-493 (Del. S.C. 1966).

However in *Abella v. Universal Leaf Tobacco Co.,*[57] it was held that a derivative suit could proceed notwithstanding the recommendation of the committee for dismissal. Even with this, most corporation laws require the court to pay deference to the committee's decision.

Further Sarah Stegemoeller had proposed four main policy reasons behind the court's approach of paying deference to the committee's business decision.[58] First, if the court were to be holding every director's decision not measuring up to standard as culpable, then highly qualified managers will not like to serve on the board since they will be required to exhibit a higher degree of responsibility and so can be held for mere errors in their judgement.

Second, it is recognized that the corporate financial resources is an aggregation of shareholders resources and that such is to be used by the directors for the corporate objectives of the shareholders under the assumption of risk. Thus courts have refrained from questioning the business/management decisions of the managers by reasoning that those who seek to benefit from corporate profitability have impliedly agreed to be bound by the business judgement of their elected managers.

Third, courts have over the years recognized that they are fundamentally ill-equipped to take business decisions for corporations or even to question such business decisions and that such decisions are best left to the opinion and reasonings of seasoned managers who are most suited to act in that capacity. The courts have accepted that "invariably, such decisions must be predicated upon factors which do not lend themselves to judicial scrutiny: 'questions

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[57] 495 F.Supp. 713 (E. D. Va. 1980); see also *Miller v. Register & Tribune Syndicate, Inc.,*336 N.W.2d 709 (Iowa 1983), where two corporation's directors who were named parties to the suit were barred from composing or delegating to a special committee the power to bind the corporation as to the conduct of the suit.

[58] For a detailed information on the rationale behind the business judgement rule and the attitude of the court see Sarah M. Stegemoeller, *supra* note 54 at 339.

of policy of management, expediency of contracts or action, adequacy of consideration, lawful appropriation of corporate funds to advance corporate interests.'"[59] are best within the managers' role and duties.

Finally, it is necessary to pay deference to managers business judgement so as to serve as an efficient bar against unmeritorious, frivolous and vexatious strike suits that are not in the interest of the corporation thus conserving the court's time, resources and energy as well as the coporation's funds and resources.[60]

Over the years the business judgement was applied to effectively shut out the shareholders legitimate claims,[61] and in many decisions,[62] the court upheld the committee's business pre-trial motions to dismiss the shareholder's suit.

Gordon Phillips thus noted that it is notorious that those 'disinterested' directors almost always decided in every case that the company ought not to sue and the result was an application by the company to have the derivative action dismissed.[63] Bruce Welling too noted that where the committee's report supports an action against the wrongdoers the report

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[59] *Ibid.*

[60] See A. G. Anderson, "Conflicts of Interest: Efficiency, Fairness and Corporate Structure" (1978) 25 U. C. L. A. L. Rev. 738.

[61] See John C. Coffee, Jr. & Donald E. Schwartz,"The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform" (1981) 81 Colum. L. Rev. 261, where they proffered various reasons why the court should not pay unnecessary deference to the special committee's business decisions. These are examined later in this chapter.

[62] *Hawes v. Oakland,* 104 U. S. 450 (1881); *Corbus v. Alaska Treadwell Gold Mining Co.,* 187 U.S. 455 (1903); *United Copper Securities Co. v. Amalgamated Copper Co.,* 244 U.S. 261 (1917); *Dodge v. Woosley,* 59 U.S. (18 How.) 331 (1855); *Ashwander v. Tennesse Valley Authority,* 297 U.S. 288 (1936); *Grossman v. Johnson,* 89 F. R. D. 656 (D. Mass. 1981) *aff'd* 674 F.2d 115 (1st Cir. 1982); *Cramer v. General Tel. & Electronics Corp.,* 582 F.2d 259 (3d Cir.) cert denied., 439 U.S. 1129 (1978).

[63] See Gordon Phillips, *supra* note 12 at 397.

would disappear, or if the report is negative, it will be filed with the court as evidence against the proposed action.[64] By the 1970s and 1980s, the derivative action which had originated in equity to assist the minority shareholder had become a dormant force in the regulation of intracorporate acts, and thus Coffee and Schwartz submitted that:

> The Shareholder derivative suit today faces extinction. Long considered the 'chief regulator of corporate management,' and a recognized form of litigation in American courts at least since 1855, it now confronts the second great challenge of its history.[65]

In solving the tension created by the committee's dismissal motion and the shareholder's derivative right, the American courts have evolved two approaches. In effect, the scope of the court's judicial review of the directors and committee's pretrial motion for a dismissal, for resolving the friction between the managers and the shareholders, and the evaluation and application of the business judgement rule revolves between the traditional *minimal review* approach as was enunciated in *Auerbach v. Bennett,*[66] and the *two-step moderate review* of *Zapata Corporation v. Maldonado.*[67]

a. The Traditional Minimal Review Approach

The traditional minimal review approach simply requires that after the committee recommends dismissal, the plaintiff shareholder may show that the committee members were not truly independent or disinterested, or did not act in good faith, or that their investigations

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[64] See Bruce Welling, *supra* note 30 at 530.

[65] See John Coffee, Jr. and Donald Schwartz, *supra* note 61 at 261.

[66] 393 N.E.2d 994 (N.Y.C.A. 1979).

[67] 430 A.2d 779 (Del. S.C. 1981).

and deliberations were not sufficiently diligent. Thus in *Auerbach v. Bennett,*[68] the New York Court of Appeals held that the business decision and the pre-trial motion of the committee to dismiss the derivative action will be upheld only where the following points could be proved. (1) Where the committee was disinterested in the act complained of; (2) Where the committee members are independent of the alleged wrongdoers; And (3), where the investgative procedures and techniques adopted by the committee were thorough and adequate. Accordingly, Jones, J. held that:

> In the present case we confront a special instance of the application of the business judgment rule and inquire whether it applies in its full vigor to shield from judicial scrutiny the decision of a three-person committee of the board not to prosecute a shareholder's derivative action....Nothing suggests that any of the other directors participated in any of the challenged first-tier transactions....The business judgement rule does not foreclose inquiry by the courts into the disinterested independence of those members....We turn then to the action of the special litigation committee itself which comprised two components. First, there was the **selection of procedures** appropriate to the pursuit of its charge, and second, there was the **ultimate substantive decision**, predicated on the procedures chosen and the data produced thereby, not to pursue the claims advanced in the shareholders' derivative actions. The latter, substantive decision falls squarely within the embrace of the business judgement doctrine, involving as it did the weighing and balancing of legal, ethical, commercial, promotional, public relations, fiscal and other factors familiar to the resolution of many if not most corporate problems. To this extent the conclusion reached by the special litigation committee is outside the scope of our review. Thus, the courts cannot inquire as to which factors were considered by that committee or the relative weight accorded them in reaching that substantive decision....As to other components of the committee's activities, however, the situation is different, and here we agree with the Appellate Division. As to the methodologies and procedures best suited to the conduct of an investigation of facts and the determination of legal liability, the courts are well equipped by long and continuing experience and practice to make determinations. In fact they are better qualified in this regard than are corporate directors in general....At the same time those responsible for the procedures by which the business judgement is reached may reasonably be required to show that they have pursued their chosen investigatve methods in good faith....may be expected to show that the areas and subjects to be examined are reasonably complete and that there has been a good faith pursuit of inquiry into such areas and subjects.[69]

It is clear from the above that all the court requires to uphold the committee's decision

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[68] 393 N.E.2d 994 (N.Y.C.A. 1979).

[69] *Ibid.* per Jones, J. at 1000-1003.

is that the committee members are independent and disinterested, follow a thorough and adequate investigative procedure, and act in good faith.[70] To this end, Professor Robert Clark submitted that if the plaintiff can prove either lack of independence, committe members' interest in the impugned transaction, or lack of adequate information and bases for the committee's decision, then the committee's motion for dismissal will be rejected. Whereas if the shareholder cannot prove any of the above grounds, then the committee's business decision and pretrial motion will not be scrutinized, and the court will treat it as shielded by the business judgement rule.[71] Bruce Welling has likened the American courts' "traditional minimal review" approach to an *administrative tribunal review* whereby the committee's decision-making process and not its substantive decision is evaluated by the court, and so long as the committee complies with the formal requirements in arriving at its decision, such decision is precluded from judicial review.[72]

Richard Brown has similarly submitted that the role of the court in administering the business judgement rule under this approach is limited to an examination of the credentials of the committee members and the investigative procedures which they have adopted, and not the substance of their decision,[73] and in which circumstances the traditional approach's effect

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[70] This approach has been followed in *Gaines v. Haughton*, 645 F.2d 761 (9th Cir. 1981); *Lewis v. Anderson* 615 F.2d 778 (9th Cir. 1979); *Genzer v. Cunningham*, 498 F.Supp. 120 (S.D.N.Y. 1981); *Breezy Point Cooperative Inc. v. Young*,506 N.Y.S.2d 366 (1986); *Hasan v. Clevetrust Realty Investors*,729 F.2d 372 (1984); *Citytrust and Citytrust Bancorp, Inc. v. Joy*, 460 U.S. 1051 (1983).

[71] Robert Clark, *supra* note 46 at 646.

[72] See Bruce Welling, *supra* note 30 at 531.

[73] See Richard C. Brown, "Shareholder Derivative Litigation and the Special Litigation Committee" (1981-82) 43 U. of Pitt. L. Rev. 601 at 632-633.

will not be a very profitable weapon in the hands of the shareholder where the committee members were independent, disinterested, acted in good faith, and had adopted a reasonable procedure, but had reached a decision that was not in the best interest of the corporation based on some covert but inimical interests, or where some other subtle but compelling and germaine corporate interests necessitate that the shareholder's derivative action be heard.[74]

b. The Moderate Two Step Review Approach

Following the problems encountered with the application of the traditional approach, the Delaware Supreme Court in *Zapata Corporation v. Maldonado,*[75] adopted a *two-step moderate* test for reviewing the committee's pre-trial motion to terminate a shareholder action, and consequently, the court held that it must first of all ascertain that the committee of uninterested directors acted independently, in good faith and followed a proper procedure. In doing so it should examine the bases for the conclusions of the committee. Second, even if the committee meets the first step, the court will apply its own business judgement by considering other factors like the corporation's best interests, the shareholders interests and the public interest. The trial judge, Quillen, J. held that:

> We are not satisfied, however, that acceptance of the 'business judgement' rationale at this stage of derivative action is a proper balancing point. While we admit an analogy with a normal case respecting board judgement, it seems to us that there is sufficient risk in the realities of a situation like the one presented in this case to justify caution beyond adherence to the theory of business judgement. Moreover, notwithstanding our conviction that Delaware law entrusts the corporate power to a properly authorized committee, we must be mindful that directors in the same corporation and fellow directors, in this instance, who designated them to serve both as directors and committee members. The question naturally arises whether a 'there but for the

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[74] In *Lasker v. Burks,*567 F.2d 1208 at 1202 (2d Cir. 1978), the court noted that since those directors composing the committee will at various times and at later times deal with the impugned directors, then the assumption that they were acting independently is questionable.

[75] 430 A.2d 779 (Del. S.C. 1981).

> grace of God go I' empathy might not play a role. And the further question arises whether inquiry as to independence, good faith, and reasonable investigation is sufficient safeguard against abuse, perhaps subconscious abuse...The Court should apply a two-step test to the (defendant's) motion. First, the Court should inquire into the independence and good faith of the committee and the bases supporting its conclusions. Limited discovery may be ordered to facilitate such inquiries. The corporation should have the burden of proving independence, good faith and a reasonable investigation, rather than presuming independence, good faith and reasonableness. If the court determines either that the committee is not independent or has not shown reasonable bases for its conclusions, or, if the Court is not satisfied for other reasons relating to the process, including but not limited to the good faith of the committee, the Court shall deny the corporation's motion. If however, the Court is satisfied...that the committee was independent and showed reasonable bases for good faith findings and recommendations, the Court may proceed, in its discretion, to the next step. The second step provides, we believe, the essential key in striking the balance between legitimate corporate claims as expressed in a derivative stockholder suit and a corporation's best interests as expressed by an independent investigating committee. The Court should determine, applying its own independent business judgement, whether the motion should be granted. This means, of course, that instances could arise where a committee can establish its independence and sound bases for its good faith decisions and still have the corporation's motion denied. The second step is intended to thwart instances where corporate actions meet the criteria of step one, but the result does not appear to satisfy its spirit, or where corporate actions would simply prematurely terminate a stockholder grievance deserving of further consideration in the corporation's interest. The Court of Chancery must carefully consider and weigh how compelling the corporate interest in dismissal is when faced with a non-frivolous lawsuit. The Court of Chancery should, when appropriate, give special consideration to matters of law and public policy in addition to corporation's best interests.[76]

In support, Professor Robert Clark submitted that this approach provides for a moderate scrutiny,as the court will first inquire into the independence, good faith and the bases for supporting the committee's conclusions,and the committee has the burden of proving the above requirements. Where the court either finds that the committee can not prove its independence, good faith or reasonable bases for its conclusion, or if for any other reason relating to the process by which the committee reached its decision the court is not satisfied, then it should deny the committee's pre-trial motion.

Second, even if the court is satisfied that the procedural grounds have been met, it

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[76] *Ibid.* per Quillen, J. at 787-789.

may proceed, in its discretion, by applying its own business judgement, to see whether the motion should be granted. The court may consider matters of law and public policy in addition to the corporation's best interest, and should try to balance legitimate corporate claims as expressed in a stockholder suit against the corporation's best interest as expressed by an independent investigatory committee.[77]

There have been various criticisms of the *Zapata* approach. First, it was condemned as giving the court open-ended flexibility instead of laying down clearly identifiable and determinative parametres as to the scope of judicial review, and since legal rules are always required to be clear, exact and succint, its profitability was seriously doubted. Second, it was denounced as an avenue for generating more corporate litigations due to legal and procedural issues left untouched in the *Zapata* decision.[78] Third, it was argued that courts are not competent to make the relevant business decisions on behalf of more qualified managers, as a decision to institute corporate action is a business decision which is predominatly and

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[77] Robert Clark, *supra* note 46 at 646-647; Also according to Edward Welch & Andrew Turezyn , *supra* note 49 at 853, "The court applies a two-step test analysis to the motion. First, it inquires into the independence and good faith of the committee in making its investigation and the reasonableness of the bases relied on by the committee to support its conclusions. In this step, the corporation has the burden of proving independence, good faith, and a reasonable investigation. The corporation's burden is the same as under a Rule 56 motion for summary judgement; to show that there is no genuine issue of material fact and that it is entitled as a matter of law to have the complaint dismissed. If the corporation fails to meet its burden, its motion is denied. If the corporation has borne its burden under the first step, the court may either grant the motion and dismiss the derivative suit or, in its discretion, proceed to *Zapata*'s second step....the court applies its own independent business judgement.....in addition to the corporation's best interests, give special consideration to matters of law and public policy."

[78] Dennis J. Block & H. Adam Prussin, "The Business Judgement Rule and Shareholder Derivative Actions: Viva *Zapata*?" (1981) 37 Business Lawyer 27. See also George W. Dent, Jr., "The Power of Directors to Terminate Shareholders Litigation: The Death of the Derivative Suit" (1980-81) 75 NW. U. L. Rev. 96.

exclusively within the board's powers.[79] Fourth, it was stated that the impact of the action on the public, employee, and commercial relations may militate against the corporation's interest on the long run.[80]

Notwithstanding the above criticisms, this writer supports the two-step approach in *Zapata Corporation v. Maldonado,* as it gives the court a more active role to play by examining in detail the committee's decision while it seeks to ascertain the corporation's best interests and spirit in the light of the shareholder's grievance which deserves further beneficial favourable consideration towards deciding whether to dismiss the derivative action pursuant to the committee's pre-trial motion.[81] In this connection, the traditional approach is not a profitable weapon for the shareholder as it ties the hands of the court and reduces the court's role to a passive one, and according to Richard Brown:

> [I]n applying the *Zapata* two-step test, the trial court is required to play a very expansive and undefined role...[u]nder the Delaware formulation, however, the court, in making its own judgement, is not restricted to just a consideration of whether the best interests of the corporation will be served by the maintenance of the litigation. Matters of law and public policy

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[79] Daniel R. Fischell, "'The Race to the Bottom' Revisited: Reflections on Recent Developments in Delaware's Corporation Law" (1982) 76 Nw. U. L. Rev. 913 at 938 noted that: "A decision whether or not to sue is conceptually identical to other business decisions that management must make. A wide variety of factors must be considered before the decision is made. Management must determine whether the corporation has a valid claim against the alleged wrongdoer, and if so, what the likelihood and magnitude of recovery are expected to be. Management also must decide whether it can take any steps other than litigation against the alleged wrongdoer. If the alleged wrongdoer is an insider, for example, a reduction in salary or bonus may be a preferable alternative to litigation."

[80] *Ibid.*

[81] The two-step test has been applied in *Joy v. North,* 692 F.2d 880 (2d Cir. 1982) cert denied, 460 U. S. 1051 (1983); *Lewis v. Fuqua,*502 A.2d 962 (Del. Ch. 1985) *interlocutory appeal refused in* 504 A.2d 571 (Del. S.C. 1986); *Abbey Computer v. Computer & Communications Technique Corp.,* 457 A.2d 368 (Del. Ch. 1983); *Kaplan v. Wyatt,*484 A.2d 501 (Del. Ch. 1984);*Grafman v. Century Broadcasting Corporation,*762 F.Supp. 215 (N.D. Ill. App. 1991) (applying Delaware law.); *Abramowitz v. Posner,* 672 F.2d 1025 (1982); *Stotland v. GAF Corporation,* 469 A.2d 421 (Del. S.C. 1983); *Re General Tire & Rubber Co Securities Litigation,* 726 F.2d 1075 (6th Cir. 1984); *Watts v. Des Moines Register and Tribune,*525 F.Supp 1311 (1981).

> may also be taken into account....The Delaware approach to derivative litigation makes the court, in the exercise of its own independent judgement, the ultimate arbiter of whether a shareholder should be allowed to litigate a corporate claim.The private litigation decision of a special committee may always be superseded by the independently made litigation decision of the court. In this sense, the function of the court under Delaware rules is not primarily that of reviewing the privately made litigation decision of a special committee; rather, the basic function of the court is to make its own litigation decision and then impose this publicly made decision upon the parties.[82]

The widened role of the Court under the two-step test, will certainly do more substantial justice than the limited role of an administrative tribunal.[83] For instance in *Greenfield v. Hamilton Oil Corp.*,[84] the court held that a special litigation committee's negative recommendation did not bar a shareholder's derivative claims as the committee was only given the power of recommendation, and since the ultimate decision as to whether or not to initiate corporate litigation was retained by the accused directors, the court will uphold the minority shareholder's action.

It is very evident that corporation law will serve its purposes in a system that allows the court to closely scrutinize the business decision of the committee for the following reasons. First, the committee members being internal members of the impugned board are likely to be biased. Where there are few outside directors in the committee, they are suspectible to bias and empathy in their decision. Commenting on this line of reasoning, Brown noted:

> This is the problem of bias. The provenance of special committee always raises the spectre of committee members being consciously or sub-consciously prejudiced in their deliberations.

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[82] See Richard C. Brown, *supra* note 73 at 642-643; See also John Coffeee, Jr. & Donald Schwartz, *supra* note 61 at 281-283.

[83] See Bruce Welling, *supra* note 30 at 531-533; see also Gordon Phillips, *supra* note 12 at 397 and Gudmundseth & Draibye, *supra* note 15 at 3.1.10.

[84] 760 P.2d 664 (Colorado Ct. App. 1988).

> Judicial techniques for the detection of bias are at best superficial. Being a state of mind, bias and particularly subconscious bias are rarely suspectible of objective proof in the usual judicial manner....The recognition of this fact is crucial to the development of an appropriate judicial approach to special committees.[85]

Second, it has also been noted that since the committee's members, particularly, the outside directors are usually selected by the board controlled by the wrongdoing majority, their independence and impartiality can be compromised. This flows from the fact that they will invariably owe some allegiance to their impugned colleagues[86]

Third, the fact that the suit is being opposed by the committee on the usual ground of"best interests of the corporation"should not be a boot-strap argument to keep the court out from examining the actual facts of the case, thus George Dent has argued:

> Even a meritorious suit may be detrimental to the corporation. In the decided cases, special litigation committees have often pointed to the costs of litigation, the interruption of corporate business, and the undermining of personnel morale as reasons for not bringing suit. To some extent these reasons could justify opposing a derivative suit. Although certain steps by the corporation, such as demanding security for expenses or seeking a protective order from the court, can sometimes diminish these problems, they cannot always be eliminated...in sum, the quantifiable monetary costs to the corporation of a particular suit are unlikely to harm the corporation substantially, and in general these costs probably do not greatly exceed the quantifiable monetary benefits of derivative suits. Moreover, the total benefits of derivative suits far outweigh their detriments. Accordingly, the directors' decision that a derivative suit against their colleagues should be halted because of its potential costs outweigh its potential benefits should only be considered as one relevant factor when a minority of directors is sued and should be disregarded when a majority is sued.[87]

Fourth, unlike normal business decisions often made under pressure of time and uncertainty, a decision to terminate litigation is made under a more relaxed atmosphere, and so uncertainty is less a factor since it permits greater time for investigation and the relevant

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[85] Richard C. Brown, *supra* note 73 at 647.

[86] *Ibid.*

[87] See George W. Dent, "The Power of Directors to Terminate Shareholders Litigation: The Death of The Derivative Suit" (1980-81) 75 Nw. U. L. Rev. 96 at 142-144.

facts now exist in history both in the court's records and corporate files. Thus the court must refuse to be bound by the committee's decision on grounds of expediency.[88]

Fifth, it has also been suggested that the judicial immunity usually accorded intra-corporate business decisions because of the need to free directors from fear of liability for errors in judgement ought not be given to the committee's pre-trial dismissal motions. This is because at this stage the directors face little risk of liability as is the case when making business decisions.[89]

Finally, unlike an intra-corporate business decision which relates to the future and is therefore predictive, a pre-trial dismissal motion is retrospective, and the court is able to sift and balance the same evidence as was presented to the board and committee. The necessary facts and records will be available for the court to scrutinize and make its own decision.[90]

While some other legal writers have advocated that the final decision should lie with the shareholders as a whole, Harvard Dean Robert Clark has submitted that because of the optimal cost and the need to prevent strike suits and unmeritorious claims, it may not be fashionable to place power over and control of corporate litigation with the shareholders general meeting. Thus while supporting the *Zapata* two-step tests, he further suggested a possible alternative, i.e. the use of "court appointed committees" in that when requested by

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[88] John Coffee, Jr. & Donald Schwartz, *supra* note 61 at 281.

[89] *Ibid.* at 281-282.

[90] *Ibid.* at 282-283. See also Daniel R. Fischell, "'The Race to the Bottom' Revisited: Reflections on Recent Developments in Delaware's Corporation Law" (1982) 76 NW. U. L. Rev. 913; F. A. Gevutz, "Who Represents the Corporation: In Search of a Better Method for Determining the Corporate Interest in Derivative Suits" (1984/85) U. of Pitt. L. Rev. 265; Ronald J. Gilson and Reiner Kraakman, "Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?" (1989) 44 Business Lawyer 247.

the board, the court might in its discretion, appoint a special committee of independent and knowledgeable persons to determine whether the continuance of the suit would be in the corporation's best interest.[91] This court appointed committee procedure is similar to the provisions of sections 800(b)(2) and 626(c) of the California *General Corporation Law* and New York *Business Corporation Law* respectively. The court-appointed committee's decision would thereafter be reviewed by the court to determine whether it followed the tests laid down in *Auerbach v Bennett,*[92] regarding independence, good faith and sound bases for its judgment. In this way, the court is saved from making business decisions, and at the same time the committee will be less pro-defendant biased.[93]

VIII. Conclusion

From the above study, it appears that the only aspect that will present some novelty to Nigerian courts is the American courts approach in the use of the Special Independent Litigation Committee's business decision or the review of the committee's pre-trial motion to terminate the shareholder's derivative suit based on the company's best interests. It is proposed that when faced with the task of determining the corporation's best interest between the shareholder and the litigation committee's positions, Canadian and Nigerian courts should adopt the moderate two-tier approach in *Zapata Corporation v. Maldonado.*[94] It affords the courts ample opportunity to scrutinize both the substantive suit and motion, and prevents

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[91] *Miller v. Register and Tribune Syndicate, Inc.*, 336 N.W.2d 709 (Iowa 1983).

[92] 393 N.E.2d 994 (N.Y.C.A. 1979).

[93] See Robert Clark, *supra* note 61 at 645-649. See also J. Schnell, "A Procedural Treatment of Derivative Suit by Minority Directors" (1981) 69 Calif. L. Rev. 885.

[94] 430 A.2d 779 (Del. S.C. 1981).

meritorious shareholder suits against unscrupulous managers from being dismissed on flimsy technical grounds, and in this connection Scott Turner noted thus:[95]

> Leaving aside procedural differences, it is submitted that there is room in B. C. (as well as all other Canadian jurisdictions) for courts to consider the views of the independent directors in deciding whether or not to grant leave. If this approach is to be taken, for example in the case of larger, public companies, then great care should be taken in the selection of the independent committee. The latter should, as appropriate, probably retain independent counsel to assist in its deliberations. If, at the conclusion of these deliberations, an independent committee were to decide that it is not in the interests of the company to proceed, then it is suggested that it would be appropriate for the committee to prepare some written memorandum of its deliberations and decisions, if a court is to give any weight at all to those views. Of course, if an independent committee structure is to work, the company must have proper notice of the claims advanced and, as indicated above, as much detail as possible, to assist it in its deliberations.

We shall now consider the nature, extent, and scope of the regulatory powers granted to the courts for the proper conduct of the derivative suits.

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[95] See Scott Turner, "Derivative Actions" in *Shareholders' Remedies* (Materials Prepared for The Continuing Legal Education Society of British Columbia Seminar, *New Developments in Shareholders' Remedies,* held in Vancouver, B. C. on November 28, 1996) at 1.1.18. It may be noted that some Canadian courts have applied the independent committee business decision rule, for example in *Bellman v. Western Approaches Limited* (1981), 33 B.C.L.R. 45 (C.A.); and *Benarroch v. City Resources (Can) Ltd.* (1991), 54 B.C.L.R. (2d) 373 (C.A.).

CHAPTER 5

CONDUCT OF THE DERIVATIVE ACTIONS AND THE POWERS OF THE COURT

The CBCA grants broad powers to a court in a statutory derivative action to "make any order it thinks fit," including orders concerning the conduct of the action and orders for the payment of the complainant's legal costs by the corporation. The court is empowered to order that any damages or other amounts payable by a defendant in a derivative action to the corporation be paid instead, in whole or in part, directly to former or present security holders. This provision is intended to prevent corporate wrongdoers from sharing in the recovery obtained by the complainant's efforts.[1]

I. Introduction

This chapter considers the various powers granted the court by the corporation statutes for the conduct and regulation of the derivative action after the court has granted leave to the applicant to sue derivatively. In particular, it considers the provisions of the CAMA and ABCA and relevant American corporation laws issues such as cost and security deposit, settlement and discontinuance, personal awards, and other regulatory powers of the court. While the statutes recognize that the shareholder be allowed to enforce corporate rights in some instances, they also recognize the danger in leaving the derivative rights of the shareholder at large without necessary checks and balances as being likely to be abused via frivolous and vexatious proceedings.

II. Funding And Costs of the Derivative Action

a. Security Deposit

In America, the individual shareholder was required to post security for all the

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[1]McCarthy Tetrault, *Directors, and Officers' Duties and Liabilities in Canada* (Toronto: Butterworths, 1997) at 74-75.

corporation's legal expenses arising from the action.[2] Historically, this requirement emerged during the Great Depression period in America in the 1930s when a great number of strike suits were instituted. Consequently, the *Wood Report* (the report of the Committee set up by the New York Chamber of Commerce[3] to look into the problem) recommended that a security deposit requirement was necessary to curb the menace of frivolous strike suits.[4]

The typical security for expenses statute requires a derivative plaintiff to post a substantial bond in order to ensure his ability to reimburse the defendants for litigation expenses if he ultimately loses the action.[5] In America, most modern corporation laws provide for the posting of security deposit for expenses. For example, section 627 of the New York *Business Corporation Law*[6] provides that the plaintiff shall post a security deposit for legal expenses unless he owns at least 5% of the corporation's shares or where his shareholding has a market value greater than $50,000. The corporation shall have recourse to it in such amount as the court may determine at the end of the suit.

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[2] See *Cohen v. Beneficial Industrial Loan Corporation,* 337 U.S. 541 (1949).

[3] *Survey and Report Regarding Stockholders' Derivative Suits (1944),(the Wood Report),* prepared by the Special Committee on Corporate Litigation of the Chamber of Commerce of the State of New York.

[4] For the background history of the *Wood Report* and security deposit, see Robert Clark, *Corporate Law,* (Boston: Little Brown & Co., 1986) at 653-655; see also George D. Hornstein, "The Death Knell of Stockholders Derivative Suits in New York" (1944) 32 Calif. L. Rev. 123.

[5] John S. Martel & Charles M. Sink, "The Derivative Action: Is There Life After Lasker?" in J.S. Martel, ed., *The Investor And The Corporation: New Developments And Tactics in Stockholder Litigation* (New York: Practising Law Institute, 1980) 197 at 243.

[6] New York *Business Corporation Law*, (McKinney 1996); see also the California *General Corporation Law,* s. 800(c)-(f) (West 1990) whch provides that the court will only require the plaintiff to post a security for deposit after it makes a finding that either:

> There is no reasonable possibility that the prosecution of the cause of action alleged in the complaint against the moving party will benefit the corporation or its shareholders; or
> That the moving party ....did not participate in the transaction complained of in any capacity.

According to the *Wood Report*, this requirement was to prevent shareholders who had very little to lose through injurious suits from instituting unmeritorious actions which will involve the corporation's time and funds. As such, they were required to post such security so that if the suit was eventually thrown out, the shareholder would bear the cost of having involved the corporation in an unnecessary litigation.[7]

However as far back as 1944, there have been criticisms against this requirement,[8] and shareholders devised various ways to circumvent it. [9] Firstly, as soon as the defendants moved the court for the posting of security deposit, the court would grant a stay and the shareholder would then solicit other shareholders so as to meet the 5% minimum shareholding requirement and by so doing evaded the deposit requirement. Secondly, the erring defendant managers who, usually were publicity averse, decided not to ask for security deposit out of fear that the shareholder may publicize their wrongdoings. Thirdly, shareholder plaintiffs also decided to initiate their claims under federal securities regulations in federal courts or in states like Delaware which had no security-for-expense requirement at all.[10] By the 1970s, the security deposit requirement had outlived its usefulness in America.[11]

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[7] See *Beyerbach v. Juno Oil,* 265 P.2d. (Cal. 1954); *Bank of Montreal v. Northguard Holdings Ltd.* (1989), 58 Man. R. (2d) 241 (C.A.).

[8] George D. Hornstein,"The Death Knell of Stockholders' Derivative Suits in New York"(1944) 32 Calif. L. Rev. 123; George D. Hornstein, "New Aspects of Stockholders' Derivative Suits" (1947) 47 Colum. L. Rev. 1; George D. Hornstein, "Problems of Procedure in Stockholder's Derivative Suits" (1942) 42 Colum. L. Rev. 574; George D. Hornstein, "Directors' Expenses in Stockholders' Suits" (1943) 43 Colum. L. Rev. 301.

[9] Notes, "Security for Expenses in Shareholders' Derivative Suits: 23 Years' Experience" (1968) 4 Colum. J. of L. & Social Prob. 50.

[10] Notes, "Defenses in Shareholder Derivative Suits-Who May Raise Them?" (1952) 66 Harv. L. Rev. 342.

[11] Robert Clark, *supra* note 4 at 654; Notes, "Security for Expenses in Shareholders' Derivative Suits: 23 Years' Experience" (1968) 4 Colum. J. of L. & Social Prob. 50.

The requirement of security posting is now statutorily abolished in Nigeria and Canada, and under sections 307 and 235(3) of the CAMA and ABCA respectively, the complainant is not required to give security for costs in any derivative action. As to this provision, the Dickerson Committee noted that:

> (This provision)....is self-explanatory. Its purpose is to ensure that a shareholder may institute a derivative action before any court in Canada without being required to put up security for costs. We think that court scrutiny of such actions, applying the standards set out ....constitutes a sufficient safeguard against frivolous actions or 'strike suits.' Incidentally, (this provision)..reflects a bias against those corporation statutes that specifically entitle a defendant corporation to demand security for costs in connection with a derivative action, a policy which has been vigorously censured by legal scholars...[12]

This writer supports the statutes express abrogation of the security deposit requirement in Canada and Nigeria, as the average shareholder may lose the confidence to come to court to enforce corporate rights under the fear that apart from depositing a substantial security he may end up paying the whole cost of the litigation, if he loses at the end. However it is also important to note that security deposit as a means of checking unmeritorious and abusive suits has received support in America from Roberta Romano,[13] as she puts it, "the efficacy of shareholder litigation as a governance mechanism is hampered by collective action problems because the cost of bringing a lawsuit, while less than the shareholders' aggregate gain, is typically greater than a shareholder-plaintiff's pro rata benefit."[14] After conducting a survey of all shareholder suits (personal, class and derivative

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[12] See *Proposals For a New Business Corporations Law For Canada, (the Dickerson Report)* Vol. 1 (Ottawa: Information Canada, 1971) at para. 439.

[13] See Roberta Romano, "The Shareholder Suit: Litigation Without Foundation?" in Roberta Romano, ed., *Foundations of Corporate Law (Interdisciplinary Readers in Law)* (New York: Oxford University Press, 1993) 170 (The same article is published in (1991) 7 Journal of Law, Economics, and Organization 55).

[14] *Ibid.*

suits) in the late 1960s in New York, it was found out that:

> [T]o the extent that derivative suits consistently return less to shareholders than class actions, there is a greater likelihood that more of these suits are frivolous. It is also possible that the misconduct giving rise to derivative claims is less serious than that of class action.[15]

Second, the survey revealed a "free-rider problem" in that litigation costs usually surpass the individual benefits as per share recovery. In other words, the cost of financing the suit both for the defendant directors and the plaintiff shareholder, attorney fees and other expenses are usually of higher magnitude compared to the shareholder recovery either through settlement or dividends. She then concluded that:

> The evidence of indirect benefits from litigation serving as a backup monitor of management is mixed. There is scant evidence that lawsuits function as an alternative governance mechanism to the board...Lawsuits can, however, be useful for outside blockowners...Finally, inside ownership seems to serve as a successful alternative monitor for negligence but not for conflicts of interest...One potential social benefit from a shareholder suit that is ancillary to its role as a governance device has not been discussed: legal rules are public goods. All firms benefit from a judicial decision clarifying the scope of permissible conduct. The benefit of clarification is not simply deterrence of future managerial misconduct, but rather, given the contractual setting of the corporation, identification of a rule around which the parties (managers and shareholders) can transact. As few suits produce a legal rule....., this explanation of lawsuit efficacy turns on the need for a large number of lawsuits in order to obtain a ruling. There is no reason to believe that the current level of litigation is optimal in relation to any public good benefits.[16]

Perhaps Roberta Romano's conclusion that shareholder's derivative suit is of little benefit to their ultimate benefits and public good is of some merit. However this author contends that the above submissions are no basis for justifying security deposit requirement to prevent strike-suits. This is because the equitable protection granted by the courts to shareholders is inconsistent with the requirement of asking them to post bond or security

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[15] *Ibid.* "The Shareholder Suit: Litigation Without Foundation?" in Roberto Romano, ed., *Foundations of Corporate Law (Interdisciplinary Readers in Law)* (New York: Oxford University Press, 1993) 170 at 173.

[16] *Ibid.* at 180.

deposits. Moreover, the threat of initiating such actions and actual commencement of such have either caused such wrongs to stop or forced the erring managers to settlement.

b. Legal Costs

The successful prosecution of a shareholder's derivative action depends largely not only on the factual and legal armoury of the complainant but also on sufficient funds. [17] The average conscientous shareholder may lack enough funds to prosecute a derivative action, and this is coupled with the fact that in the real sense any benefit accruing from the action belongs principally to the corporation alone, which indirectly may flow to the shareholders. Thus over the years, the courts have tried to grapple with the situations where they have to compel the more financially capable corporation to assist the shareholder, with the aim of allowing the legitimate grievances of the shareholder (which are ultimately for the corporation's best interests) to be heard and not stultified on the slab of financial inadequacy.[18]

Under the English common law, a corporation may be required to indemnify the complainant for its expenses, and thus in *Wallersteiner v. Moir (No 2),*[19] the minority shareholders whose shareholding were so small had, during the prosecution of an apparently meritorious derivative action, run out of funds. The English Court of Appeal held on the facts of the case that, a shareholder was entitled to be indemnified by the corporation for undertaking the statutory derivative action, even if the action fails on the long run. In the

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[17] See Dennis H. Peterson, *Shareholder Remedies in Canada,* (Toronto: Butterworths, 1989) at 3.1; P. Vivian, "Monetary Restraints on the Exercise of Rights of Dissenting Shareholders" (1970) 9 U. W. O. L. Rev. 101.

[18] See generally Gordon Phillips, *Personal Remedies For Corporate Injuries* (Scarborough: Carswell, 1992) at 407-418; and Dennis H. Peterson, *supra* note 17 at 3.2-3.12.

[19] [1975] 1 All E.R. 849 (C.A.).

words of Lord Denning, M.R.:

> Now that the principle is recognized, it has important consequences which have hitherto not been perceived. The first is that the minority shareholder, being an agent acting on behalf of the company, is entitled to be indemnified by the company against all costs and expenses reasonably incurred by him in the course of the agency. This indemnity does not arise out of contract express or implied, but it arises on the plainest principles of equity. It is analogous to the indemnity to which a trustee is entitled from his *cestui que trust* who is sui juris......Seeing that, if the action suceeds, the whole benefit will go to the company, it is only just that the minority shareholder should be indemnified against the costs he incurs on its behalf. If the action suceeds, the wrongdoing director will be ordered to pay the costs: but if they are not recovered from him, they should be paid by the company. And all the additional costs (over and above party and party costs) should be taxed on a common fund basis and paid by the company.....But what if the action fails? Assuming that the minority shareholder had reasonable ground for bringing the action-that it was a reasonable and prudent course to take in the interests of the company-he should not himself be liable to pay the costs of the other side, but the company itself should be liable, because he was acting for it and not for himself. In addition, he should himself be indemnified by the company if the action fails. It is a well-known maxim of the law that he who would take the benefit of a venture if it suceeds ought also bear the burden if it fails. *Quit sentit commodum sentire debet et onus.*[20]

From the above, the criterion for funding was the *reasonableness* of bringing the action. Thus the eventual success of the suit does not determine the shareholder's right to have the suit funded by the company.[21] However this has been qualified, in that where the indemnity order becomes final when made and it later turns out that the directors are not culpable, then the corporation would have been forced to bear the cost of an unmeritorious action which it did not want to pursue initially. Thus in *Smith v. Croft,*[22] it was held that such an order for indemnification by the corporation should only be made where it is proved by the shareholders that it is genuinely needed and that they do not have sufficient resources to finance the derivative action. In this connection, Walton, J. held that:

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[20] *Ibid.* per Lord Denning, M.R. at 858-859.

[21] See Gordon Phillips, *supra* note 18 at 408.

[22] [1986] 2 All E.R. 551 (Ch. D.).

> [T]he rationale for a *Wallersteiner v. Moir* order is to ensure that the plaintiff in a minority shareholders' action should not be prevented from pursuing an obviously just case through lack of funds, or fear that he may, for some reason, fail at the end of the day and be at risk as to costs which he cannot possibly pay. It has to be acknowledged that the making of such an order may turn out to have imposed on the company a liability which ought never to have been imposed on it. Therefore, one should be very careful not to extend that liability.[23]

Of course the court, additionaly, must be satisfied that the proposed action is reasonable and prudent in the circumstances before making such an indemnity order. On the other extreme in America, the shareholder has no right to funding, [24] and this has been justified on the grounds that it will serve as a deterrence to frivolous and vexatious claims and also that since the defendants will usually be the majority shareholders, an order directing that the corporation funds the action is indirectly an order that the majority shareholders fund an action against themselves and thus making it an unjust order.[25] However a strict application of the American courts' "no right to funding" will militate against a minority shareholder based on the fact that:

> In the derivative context, a mechanical interpretation of this principle would have unfortunate results. It would always require the plaintiff shareholder to pay his attorney the substantial fees involved in bringing the suit even though any recovery from the real defendants, whether by judgement or settlement, generally must go to the corporation rather than to the shareholder. There would be no lawsuits brought on a contingent fee basis under such a regime. Very few shareholders would ever have an incentive to bring a derivative suit on any realistic fee arrangement-even when a suit would be meritorious and clearly justified, on a cost-benefit analysis, for the shareholders as a group.[26]

The only exception to the rule against corporate indemnification order in a derivative

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[23] *Ibid.* per Walton, J. at 565.

[24] See *Central Shorewood Building Corporation v. Saltztein,* 152 A.L.R. 906 (Wis. S.C. 1944). According to Robert Clark, *supra* note 4 at 659, the ordinary principle about litigation expenses in American courts is that each party bears his own cost.

[25] See Gordon Phillips, *supra* note 18 at 410.

[26] Robert Clark, *supra* note 4 at 659.

action in America is where the action confers some benefit on the corporation, which was developed out of the common fund doctrine.[27] Unlike the English approach, the American courts always have to wait till the end of the action to determine whether the action would confer a benefit on the corporation and so allow the shareholder to recover his cost. In effect, there is no room for an interim indemnity order as applicable under the English common law.

The "common fund" doctrine also covers situations where, even if there was no monetary recovery for the corporation, the plaintiff shareholder's action has conferred some substantial benefit on it which forces the court to order that the corporation pays the shareholder's reasonable attorney fees,[28] as was the case in *Fletcher v. A. J. Indus., Inc.*[29]

In *Fletcher v. A. J. Indus., Inc.*, the shareholder action produced a beneficial change in the corporation's power structure leading to the removal of the controlling director and by this removing the danger of future approval of self-dealing transactions.

Further the shareholder will be entitled to reasonable attorney fees where the threat of litigation, rather than actual litigation confers some benefit on the corporation. In *Blau v. Rayette-Faberg, Inc.*,[30] the shareholder engaged an attorney to investigate certain breaches of securities regulations in the corporation. After an extensive research and legal work to

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[27] Under this doctrine, a person who undertakes the cost of an action which creates a common fund from which others could benefit from, must be compensated for his losses and expenses in creating the fund. According Robert Clark, *supra* note 4 at 660, "if the litigation brought by plaintiff produces a fund or recovery that benefits an entire class of persons, or an entity in which he along with others has an interest, the plaintiff's reasonable expenses may be taken out of the recovery." See also Edward Welch and Andrew Turezyn, in *Folk on the Delaware General Corporation Law: Fundamentals,* 1998 ed., (New York: Aspen, Law & Business, 1998) at 864.

[28] Robert Clark, *supra* note 4 at 660-661.

[29] 72 Cal. Rptr. 146 (Ct. App. 1968).

[30] 389 F.2d 469 (2d Cir.).

prevent the statute of limitations from barring the suit, the corporation decided to take some corrective actions after being alerted by the attorney. The shareholder was held entitled to his attorney fees, as his action caused the board to take the corrective action. In the same vein Edward Welch and Andrew Turezyn have identified the standards for determining whether a shareholder will be entitled to attorney fees in Delaware:

> A plaintiff in a settled or mooted action is so entitled if (1) the derivative action was meritorious when filed; (2) action producing benefit to the corporation was taken by the defendants before a judicial resolution was achieved; and (3) the resulting corporate benefit was causually related to the lawsuit.[31]

It is clear from the above that the shareholder's action must cause the benefit. Thus the shareholder bears the burden of proving causation. However, under the CAMA and ABCA there are two distinguishable instances when the court can in its discretion make indemnity orders which are the reversible and irreversible funding[32] otherwise known as interim (interlocutory) and final funding orders respectively.

i. Interim Reversible Funding

Sections 308 and 235(4) of the CAMA and ABCA respectively provide that the court may at any time order the corporation (or its subsidiary under the ABCA) to pay to the complainant interim costs, including legal fees and disbursements before the final disposition of the case. Under the ABCA, the provision goes on to provide that the complainant may be held accountable for the interim costs on the final disposition of the case.[33] According to the Dickerson Committee, the rationale for this provision is that:

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[31] Edward Welch & Andrew Turezyn, *supra* note 27 at 864.

[32] See Gordon Phillips, *supra* note 18 at 411-412.

[33] See ABCA s. 235(4).

> [This provision]....derived from s. 99 of the Ontario Act, further reflects this bias (against entitling a defendant corporation to demand costs), for it empowers the court to compel the corporate plaintiff to provide interim financing to the complainant in a derivative action, offering some assurance that apparently well founded actions will not be abandoned for lack of funds to maintain the litigation.[34]

In awarding interim costs, the courts in Canada may adopt the position stated by Dennis Peterson that "interim costs may be awarded depending on the complainant's ability to pay and the nature of the benefits if the suit is sucessful."[35] But this writer is strongly of the opinion that if there is *prima facie* merit in the suit, then the fact that the complainant may not be able to repay the the cost advanced by the corporation should not be a bar to such an award. This is line with Lord Denning, M.R. 's opinion that "...assuming that the minority shareholder had reasonable grounds for bringing the action-that it was reasonable and prudent course to take in the interests of the company...the company itself should be liable."[36]

Further it has been held that as long as it is *prima facie* in the interest of the company that the action be brought, that the complainant is acting in good faith or has exhibited some financial inability and there are no other factors suggesting otherwise, then the interim funding order will be made.[37]

As to the liability of the complainant being required to pay back the interim costs awarded, it has been suggsted that the counsel has the duty to advise the client that he may

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[34] *Proposals For a New Business Corporations Law For Canada,(the Dickerson Report)*, Vol. 1 (Ottawa: Information Canada, 1971) Vol. 1 at para. 489.

[35] See Dennis H. Peterson, *supra* note 17 at 3.3.

[36] See Lord Denning M.R., in *Wallersteiner v. Moir (No 2)*, [1975] 1 All E.R. 849 at 859 (C.A.).

[37] *Jaybird Group Ltd. v. Greenwood (*1986), B.C.L.C. 319; *Re Hillcrest Housing Ltd.* (1992), 97 Nfld. & P.E.I.R. 124 (P.E.I.S.C. Tr. Div.).

end up personally liable for all expenses and taxable costs.[38] Thus Fraley, J. held in *New Quebec Raglan Mines Ltd. v. Blok-Andersen,*[39] that the purpose of funding dissident shareholders is to allow them to have their day in court but not that they should have a completely free ride.[40] Perhaps the best approach to be adopted by both the Nigerian and Canadian Courts is to consider the sufficiency of the merits and the genuineness of the applicant's financial circumstances as stated in *Alles v. Maurice (No.1),*[41] that:

> In the end, I would prefer to say simply that an applicant for relief...need establish that there is a case of sufficient merit to warrant pursuit and that the applicant is genuinely in financial circumstances which but for an order...would preclude the claim from being pursued.[42]

ii. Final Irreversible Funding

As to final irreversible funding, sections 304(2)(d) and 233(d) of the CAMA and ABCA respectively both provide that the Court may at any time make an order requiring the corporation (or its subsidiary in the case of ABCA) to pay reasonable legal fees incurred by the complainant in connection with the action. It would appear that the court will award interim funding to the shareholder whenever it is manifestly clear that unless the order is made the legitimate claims of the corporation might be aborted and where the merits of the action are patently visible. Contrary to the position taken by Gordon Phillips,[43] this writer supports

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[38] See Stein Gudmundseth & Sandra Draibye, "Derivative Actions" in Gordon Phillips, ed., *Remedies For Corporate Injuries* (Vancouver: The Continuing Legal Education,1993) at 3.1.11.

[39] (1993), 9 B.L.R. (2d) 93 (Ont. Gen. Div.).

[40] *Ibid.* per Fraley, J. at 136.

[41] (1992), 5 B.L.R. (2d) 146 (Ont. Gen. Div.).

[42] *Ibid.* per R. A. Blair, J. at 152.

[43] See Gordon Phillips, *supra* note 18 at 417.

the award of irreversible funding to shareholders as a sort of psychological security that "come what may, they will not be responsible for the costs of the action." This is necessary especially in Nigeria where the litigation cost and attorney fees is very exhorbitant as to deter legitimate but financially handicapped minority shareholders from prosecuting a meritorious derivative action.

It is important to note that Tysoe, J. in *Intercontinental Precious Metals Ltd. v. Cooke,*[44] and *Primex Investments Ltd. v. Northwest Sports Enterprises* [45] appeared to adopt the American "common benefit" doctrine that the court will usually order final funding for legal costs where the action is successful and at the same time the amount of recovery exceeds the legal fees.

III. Settlement and Discontinuance

In the early days of derivative actions in the United States of America, there were various strike suits initiated by the shareholders against the board aimed solely at forcing the corporation to buy off their claims which were subsequently compromised via private settlements. In effect, these actions were motivated by selfish desires of the shareholders rather than the corporation's interest, a situation complicated more where a second shareholder could subsequent to the first settlement initiate another derivative suit to recover on the same wrong alleged by the first plaintiff. Such nuisance suits brought mainly for their settlement value were detrimental to the corporation's well-being and the equitable spirit of

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[44] [1994] 10 B.L.R. (2d) 203 at 225 (B.C.S.C.).

[45] (1995), 13 B.C.L.R. (3d) 300 at 316 (B.C.S.C.).

derivative suits.[46] It was not only the shareholders that were abusing the use of derivative actions. More often than not, culpable directors settled such genuine suits with corporate funds, so as to avoid publicity.[47] Lastly, since such derivative actions operated as *res judicata* against fellow shareholders who upon learning of the commencement of the suit decided to postpone their own grievances. It was thus unfair for them only to learn later that the unscrupulous shareholder had settled the claim for his own personal gain.

It was against the above background that modern American business corporation laws[48] decided to require court approval to settlements of derivative suits by statutorily providing that the action shall not be settled, dismissed or compromised without the approval of the court, and that notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs, thereby prohibiting private settlements.[49] As early as 1947, George Hornstein, in his condemnation of the security deposit provision, advocated that the court's supervision of private settlements will be a much more effective way of eradicating strike suits.[50] Modern corporation laws now require court approval. As Stanley Nemser noted:

Voluntary dismissal of a shareholder derivative action is now not allowed without court

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[46] See George W. Dent, Jr., "The Power of Directors to Terminate Shareholder Litigation: The Death of The Derivative Suit?" (1980-81) 75 Nw. U. L. Rev. 96 at 138-139.

[47] See Gordon Phillips, *supra* note 18 at 419.

[48] See Rule 23.1 of the United States of America *Federal Rules of Civil Procedure*, as amended (1993); New York *Business Corporation Law*, s. 626(d) (McKinney 1996). See generally Notes, "When Should Courts Allow Settlement of Duty-of-Loyalty Derivative Suits" (1996) 109 Harv. L. Rev. 1084.

[49] See George W. Dent, Jr., *supra* note 29 at 138.

[50] George D. Hornstein, "New Aspects of Stockholders' Derivative Suits" (1947) 47 Colum. L. Rev. 1 at 3-5.

> approval, and even if no other shareholder after notice seeks to intervene or object, such dismissal is ordinarily 'without prejudice'....A shareholder plaintiff who brings a derivative action is a fiduciary and will be required to account for any payments made directly to him for the purpose of inducing him to settle or discontinue the action by stipulation without notice....The judicial approval of the settlement, after notice and hearing, is *res judicata*, and binding upon the corporation and its shareholder.[51]

Underscoring the fact that the litigating shareholder is a fiduciary of other shareholders, Richard Ritchie has submitted that:

> The stockholder-plaintiff in a derivative action is a fiduciary vis-a-vis the other stockholders....Other shareholders may not have brought their own action in reliance on notice being sent or because the pendency of the action has been disclosed in the press or the companies reports to shareholders. Because of the fiduciary position and because other shareholders may well be relying on the plaintiff, the court may require that notice be given to all shareholders of the pendency of the action or of any proposed settlement or dismissal.The requirement of court approval of compromise or dismissal is designed to prevent strike suits and to insure the fairness of the settlement to other shareholders. Though the rule does not specifically require individual notice of the pendency, compromise or dismissal of a derivative action, the risks of not giving individual notice are substantial: they include the questionability of any *res judicata* affect, the tolling of the applicable statute or statutes of limitation, additional attorney fees in again proving that any settlement was fair, disruption of the client's business due to resolving problems which had apparently been put to rest and questioning as to the adequacy of the defendant's representation.[52]

Thus under the American business corporation laws, the litigating shareholder is a fiduciary of the other corporation's shareholders,[53] and he can attack any out of court

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[51] See Stanley Nemser, "Derivative Actions" in Stuart D. Weschler, ed., *New Directions in Securities Litigation* (New York: Practising Law Institute, 1976) at 86-87; According to Ernest L. Folk, III, in *The Delaware General Corporation Law* (Boston: Little Brown & Co., 1972) at 490-491," Since the courts recognize the 'fiduciary character' of a derivative or class action, settlement of the case requires that the court determine that the proposed settlement is fair...The purpose of the rule is to give the Court of Chancery 'meaningful supervision of a derivative settlement and to prevent abuse,' such as paying plaintiff to discontinue the action...Finally, in determining the fairness of a settlement, an important consideration is the probability *vel non* of ultimate success if the issues were to be litigated."

[52] See Richard G. Ritchie, "Derivative Actions" in Stuart D. Weschler, ed., *New Directions in Securities Litigation* (New York: Practising Law Institute, 1976) 91 at 98-99.

[53] *Clarke v. Greenberg*, 71 N.E.2d. 443 (N.Y. 1947); *Young v. Highbee Co.*, 324 U.S. 204 (1945); *Malcom v. Cities Service Co.*, 2 F.R.D. 405 (D. Del. 1942); *Tryforos v. Icarian Development Co.*, 518 F.2d 1258, (7th Cir. 1975).

settlement between the directors and other shareholders.[54] However the judicial approval of the settlement is legally binding on the corporation and all its shareholders.[55]

In this connection in *Polk v. Good,*[56] the court listed the factors to be taken into account by the court in determining whether to allow the settlement of the suit:

> (1) The probable validity of the claims, (2) the apparent difficulties in enforcing the claims through the courts, (3) the collectibility of any judgment recovered, (4) the delay, expense and trouble of litigation, (5) the amount of the compromise as compared with the amount and collectibility of a judgment, and (6) the views of the parties involved, pro and con.

Similarly, in Nigeria and Canada under sections 306 and 235(2) of the CAMA and ABCA respectively, a derivative action in Nigeria and Canada cannot be settled or dismissed for want of prosecution without the approval of the court given on such terms the court thinks fit and, if the court determines that the interests of any complainant may be substantially affected by the stay, discontinuance, settlement or dismissal, the court may order any party to the application or action to give notice to the complainant.[57]

According to the Dickerson Committee, the requirement of court approval to settlement is to prevent negligent directors from using the corporate funds to settle in order to avoid undue publicity.[58] This is also intended to take care of unscrupulous settlement or buying out in corporate disputes. In this sense, the statutory corporation laws of Nigeria and

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[54] *Wolf v. Barkes,* 348 F.2d 994 (2d Cir. 1965).

[55] *Dembitzer v. First Republic Corporation of America,* CCH Fed. Sec. L. Rep. *91, 566 (S.D.N.Y. 1965).

[56] 507 A.2d 531 at 536 (Del. S.C. 1986).

[57] For a detailed study of the powers of the court to order and conduct settlement see William E. Haudek, "The Settlement and Dismissal of Stockholders' Actions-Part II: The Settlement" (1969) 23 SW. L. J. 765.

[58] *Proposals For a New Business Corporations Law For Canada, (the Dickerson Report)*, Vol. 1 (Ottawa: Information Canada, 1971) at para. 488.

Canada go further than the American provisions as the former Acts recognise that there are instances where a faithless shareholder (who may either be sympathetic to the directors or a mere stooge or representative of the board) may institute a derivative action in order to prevent more diligent and more conscientous shareholders from litigating the same matters. Such shareholder may later undertake the prosecution of the case in such a sloppy and lackadaisical manner leading to the court's dismissal of the suit. Such situations have now been abrogated under the corporation statutes as the Court presently has various discretionary powers to put other interested parties on notice.

IV. Personal Awards

Generally the derivative action is prosecuted on behalf of the injured corporation, and it is to the injured corporation that any benefit accruing from the action goes directly and not the individual shareholder. If the court awards a direct personal recovery to the shareholder, such would amount to the court taking business decisions or declaring a dividend, a duty specifically within the ambit of the board's managerial powers. Nevertheless it has been recognized that in some instances, the award may be paid to the shareholders directly. [59] In this connection, the Dickerson Committee noted that:

> In certain cases, e.g., where a corporation has redeemed or purchased its own shares or has been liquidated or dissolved, a court can order payment directly to shareholders and former shareholders of the amount recovered, thus overcoming a technical problem that has resulted in obvious injustice in some U.S. cases. In addition, it enables the court to permit the amount recovered to flow directly through to shareholders, precluding the wrongdoers from sharing in

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[59] See generally Gordon Phillips, *supra* note 18 at 420-436; Dennis H. Peterson, *supra* note 17 at 17.28.1-17.28.2 at para. 17.51; Notes, "Individual Pro-Rata Recovery in Stockholders' Derivative Suits" (1955-56) 69 Harv. L. Rev. 1314; Richard R. Lee, "Corporations-Shareholders' Derivative and Direct Actions-Individual Recovery" (1956-57) 35 N. Carolina L. Rev. 279; Edward J. Grenier, Jr., "Prorata Recovery by Shareholders on Corporate Causes of Action as a Means of Achieving Corporate Justice" (1962) 19 Wash. & Lee L. Rev. 165.

the recovery by the corporation.[60]

Thus sections 304(2)(c) and 233(c) of the CAMA and ABCA respectively allow the Court, at any time, to make an order directing that any amount adjudged payable by the defendant in the action be paid, in whole or in part, directly to the former and present security holders of the corporation (or its subsidiary under the ABCA) instead of the corporation or its subsidiary. Commenting on this Dennis Peterson was of the view that:

> This order can be used to compensate security holders who actually suffered a loss from the wrongdoing in question. It implicitly recognizes that, although a corporation has the right to recover for wrongs perpetrated against it, it is the security holders who ultimately suffers. It is submitted that this order should be used where the impugned conduct has resulted in some disparate impact on a particular group of shareholders. If the majority unduly appropriated a corporate opportunity, for example, and this resulted in the bankruptcy of the aggrieved corporation, then the minority shareholders at the time of the bankruptcy should be individually compensated. Otherwise, any recovery should be returned to the treasury of the corporation.[61]

Over the years it has been recognized that the recoverable damages in a derivative suit may not be paid directly to the corporation. Richard Lee has explained the policy reasons behind the court's insistence on directly awarding the proceeds of the action to the shareholder in certain exceptional situations as follows: (1) where to allow corporate recovery will result in the wrongdoers partaking of the proceeds; (2) where the injury to the corporation also results in personal injury to the shareholder, i.e. depreciation in the value of his shares; (3) in such situations like in *Ritchie v. McMullen,*[62] where there is a separate personal relationship arising out of a fiduciary or contractual relationship between the

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[60] See *Proposals For a New Business Corporations Law For Canada (the Dickerson Report)* Vol. 1 (Ottawa: Information Canada, 1971) at para. 483.

[61] See Dennis H. Peterson, *supra* note 17 at 17.28.1-17.28.2 and at para 17.51.

[62] 70 Fed. 522 (6th Cir. 1897).

shareholder and the corporation, thus making the corporation a stranger to the shareholder's right of action; And (4), where the shareholder has been divested of his shares as a result of the wrong complained of, through the fraudulent or coercive conduct of the directors.[63]

In situations where the corporation is in liquidation[64] or has been phased out of existence, provided the creditors have all been paid off, the court may also order direct pro rata distribution to all shareholders.[65] For instance in *Perlman v. Feldmann*[66], the court allowed the minority shareholders to recover directly against the majority shareholder and the corporation's principal officer on the ground that a recovery to the corporation will result in heavier payments by the defendants. According to Clark, C.J.:

> We do not mean to suggest that a majority stockholder cannot dispose of his controlling stock to outsiders without having to account to his corporation for profits....Such personal gain at the expense of his co-adventurers seems particularly reprehensible when made by the trusted president and director of his company....Hence to the extent that the price received by Feldmann and his co-defendants included such a bonus, he is accountable to the minority stockholders who sue here.[67]

Similarly in *Watson v. Button*,[68] a suit involving two equal former shareholders of a corporation who had enterred into an agreement to be jointly responsible for liabilities of the corporation incurred prior to the date of the sale of the corporation. The general manager had misappropriated the corporate assets. A fact which was discovered after the sale. In an action

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[63] See Richard R Lee, *supra* note 59 at 282 - 283.

[64] *Keenan v. Eshleman,* 2 A.2d 904 (Del. S.C. 1938).

[65] See Edward J. Grenier, Jr., *supra* note 59 at 168.

[66] 219 F.2d 173 (U.S. Crt. App. 2d Cir. 1955).

[67] *Ibid.* per Clark, C.J. at 178.

[68] 235 F.2d. 235 (U.S.Crt. App. 9th Cir. 1956).

by the second shareholder, Denham, C.J. held that the:

> ...[This] court would follow those decisions from other states which allow an individual recovery in this situation, at least in a case where the rights of the creditors and other shareholders are not prejudiced. Suits against directors for violations of fiduciary duties are equitable in nature. It is unlikely that the Oregon courts would allow a director to misappropriate funds and leave those injured without a remedy.[69]

There are some objections to individual recovery. First, there is the court's usual hesitation to becoming involved in business decisions as it will impair the board's power to declare dividends. Second, it has been the court's policy that proceeds from derivative actions should be used to satisfy corporate debts before any payment to the individuals in order to avoid unjustifiable risks to creditors.[70] This writer is of the opinion that the courts in Nigeria and Canada now have wide discretionary powers under the statutes to do justice according to the facts of the case. Thus where the occasion arises that to order direct recovery to the individual shareholders would do more justice and fairness in the case, then the courts should not restrict themselves behind any rigid doctrine that derivative action proceeds must be awarded mainly to the corporation controlled or dominated by the wrongdoers.

V. Regulation of the Derivative Proceedings.

Under sections 304(2)(b) and 233(b) of the CAMA and ABCA respectively, the court may at any time make any order giving directions for the conduct of the derivative action. After granting leave to the complainant to sue derivatively, courts in Nigeria and Canada are still vested with enormous discretionary powers to regulate the conduct of the action. Thus this power may be employed to deal with specific situations such as allowing counsel access

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[69] *Ibid.* per Denham, C.J. at 237.

[70] Richard Lee, *supra* note 59 at 283-284.

to corporate information and compelling the employees of the corporation to render necessary services for the smooth running of the action. Analysing the nature of this power Dennis Peterson noted as follows:

> Giving a court power to make various orders in conjunction with leave to intervene in a derivative action arguably serves two purposes. First, orders may be made to ensure that the action is in fact conducted in the interests of the corporation. Legal counsel loyal to management might be removed to ensure that the conduct of the action does not suffer from the same problems that prompted the complainants to seek control of it. Second, the orders made in association with leave to intervene in derivative proceedings can ensure that the complainant has authority and resources to conduct the action. A complainant can be specifically authorized to control the conduct of the action, and the corporation can be ordered to pay reasonable legal fees incurred by the complainant in connection with the action.[71]

Accordingly, he summarised the direct purport of the provision as:

> This order is used to ensure that a person who has received leave to bring, prosecute, defend or discontinue an action can carry out these tasks...It is likely that a court would make orders as to the procedural nature of the action, such as granting leave to amend, abridging time periods, or ordering further examinations for discovery.[72]

To this writer, the provisions are broad enough to justify a court removing any complainant who does not adequately represent the corporation's interests and substituting him with a more vigorous, conscientous and interested shareholder in the best interests of the corporation. The provisions can also be used to justify an order that additional persons be joined as defendants to in order to recoup the corporation fully, or to take any other step for an equitable or a just disposition of the matter.

VI. Conclusion

The statutes have broadened the scope of the shareholder's derivative rights and at the same time conferred on the courts wide powers for the regulation and smooth running of

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[71] Dennis Peterson, *supra* note 17 at 17.27 and at para. 17.47.

[72] *Ibid.* at 17.28.1 and at para. 17.50.

the proceedings. These provisions are wide enough for the courts to decide each case as fairly as possible. The courts should not let the old English regime becloud their reasoning in the interpretation of these exhaustive provisions. Whenever a complainant is under any need and is pursuing a reasonable cause in the corporation's best interests, the courts are enjoined to make a funding order to the shareholder without the obligation of being liable to repay the sum back to the corporation even if the claim turns out to be unsuccessful in the end. Courts of equity are courts of justice and not courts of unreasonable adherence to legal dogmas. The last chapter compares the derivative action viz-a-viz other minority shareholder's actions.

CHAPTER 6

DERIVATIVE ACTION AND OTHER MINORITY SHAREHOLDER ACTIONS

I. Introduction

The CAMA and ABCA both contain exhaustive procedural remedies for the protection of the minority shareholder against intra corporate wrongs by the corporate managers or the controlling shareholders on the one hand, and for the enforcement of corporate rights and directors duties on the other. Particularly, Part X of the CAMA (sections 299 to 330) titled "Protection of Minority Against Illegal and Oppressive Conduct" and Part 19 of the ABCA (sections 231 to 245.1) contain comprehensive provisions on remedies and relief for redressing corporate wrongs and penalties for the same. However there are other provisions for relief and remedies elsewhere in both Acts covering other specific corporate injuries apart from Parts X and 19 of the CAMA and ABCA respectively. For instance, the appraisal remedy by which a dissentient minority shareholder in a corporation under major re-organization can request that his shares be bought out by the company, either at a price agreed to between the parties or at a judicially determined price, is provided for separately under sections 608 and 184 of the CAMA and ABCA respectively.

In effect as noted earlier in this thesis, particularly at paragraph IV of chapter 4,[1] the derivative action is not the minority shareholder's sole protective device as there are other numerous shareholder remedies such as the compliance and restraining order,[2] relief on the

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[1] Earlier on under paragraph IV in Chapter 4, we examined situations where the shareholder's derivative suit might be dismissed on the grounds that there are other specific and adequate provisions for the protection of the his allegedly breached rights which are more suitable than the chosen derivative procedure.

[2] See ABCA s. 240.

ground of oppression and unfairness,[3] an order for investigation, inspection and audit,[4] just dissolution or voluntary winding up[5] and variation of class rights.[6] There are various views on the nature of and relationship between these remedies, their occurrence and enforcement. Thus Professor Robert Clark had asked the most important question in this regard:

> What determines when a shareholder's suit should be brought derivatively, and when it should be brought directly by the individual shareholder or on behalf of a class of shareholders? The question is important because of the special procedural requirements that apply to derivative suits.[7]

Also in this connection, the court in *Goldex Mines Ltd. v. Revill*[8] held that the directors wrongful acts which simultaneously cause injury to the corporation and the shareholders will not necessarily make the injured shareholder's cause of action a derivative one, even though it may be a class action. The court also held that an action will only be a personal action if it is based on a wrong done to the shareholders personally and does not arise solely out of an injury to the corporation. These findings were fatal to the applicant's suit in that case as the court held that:

> The trouble with the endorsement is that it disclosed no attempt to differentiate between claims personal to shareholders and claims which are derivative....We have concluded that the facts set out in the material would support an endorsement making some claims for relief that are personal and are not derivative, if properly pleaded, but they are inextricably woven into the

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[3] See ABCA s. 234 & CAMA s. 311.

[4] See ABCA ss 223-230 & CAMA ss 314-320.

[5] See ABCA ss 207-221 & CAMA Part XV. See also E. Oladeji Akanki, "Judicial Discretion to Wind Up a Company" (1982) Nig. Company L. Rev. 110.

[6] See ABCA s. 170.

[7] Robert Clark, *Corporate Law* (Boston: Little Brown & Co., 1986) at 662. See also N. A. Bastin, "The Enforcement of a Member's Rights" (1977) J. of Bus. L. 17.

[8] [1973] 3 O. R. 869 (Ont. Div. Ct.); *rev'g* [1973] 1 O. R. 659; *aff'd* (1974), 7 O.R. (2d) 216 (Ont. C.A.).

derivative claims, in the present endorsement.[9]

It is thus important for the applicant to distinguish clearly whether the alleged breach or corporate wrong is one that could be enforced by a derivative action, in which case he must obtain the leave of court, or whether it is one which the shareholder can personally sue because it is a personal injury to him, in which case he can sue as of right. Consequently, this chapter examines the instances where the corporate injury affecting the shareholder can be enforced either derivatively or by a personal action. It further compares the derivative action viz-a-viz relief on the ground of oppression and unfairness.[10]

II. Derivative Actions and Personal Actions

In *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2),*[11] Vinelott, J. held that the shareholder's personal and derivative rights can be asserted in the same action, and though the English Court of Appeal[12] did not expressly comment on the proposal on appeal, it remained a moot point at common law whether such a procedural step could be taken. At common law, the dividing line between personal and derivative rights has similarly been a subject of concern over the years. According to Pennington:

> The dividing line between personal and corporate rights (to which derivative actions attach) is very hard to draw, and perhaps the most that can be said is that the court will incline to treat a provision in the memorandum or articles as conferring a personal right on a member only if he has a special interest in its observance which is distinct from the general interest which every

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[9] *Ibid.* at 226; see also *Farnham v. Fingold et al.,*[1973] 2 O. R. 132, 33 D.L.R. (3d) 156 (Ont. C.A.) *rev'g* on other grounds [1972] 3 O. R. 688 (Ont. H. C.), where the applicant's suit was dismissed on similar grounds.

[10] See generally J. G. MacIntosh, "The Oppression Remedy: Personal or Derivative?" (1991) 70 Can. Bar Rev. 29; E. Oladeji Akanki, "Controlling the Vagaries of Democracy in Companies" (1988) 15 Nig. J. of Cont. Law 111.

[11] [1981] Ch. 257 at 303-304 (Ch. D.).

[12] [1982] Ch. 204 (C.A.).

member has in the company adhering to the terms of its constitution.[13]

Generally a shareholder's personal right accrues when he suffers an injury to his personal rights as guaranteed by the corporate constitution and by-laws, while he may acquire a derivative right on the occurrence of an injury to the corporation itself, in which case his right to sue derivatively flows from the corporate injury. The CAMA has taken bold steps in trying to distinguish between the shareholder's personal and derivative rights,[14] by providing some criteria for distinguishing between the two types of actions considering the nature of the corporate injury and the remedy available. In particular, Section 301(1) of the CAMA provides:

> Where a member institutes a personal action to enforce a right due to him personally, he shall not be entitled to any damages but to declaration or injunction to restrain the company and/or the directors from doing a particular act.

Implicit in the above provision is that a personal action under the Nigerian CAMA is to enforce a personal right belonging to the shareholder. This provision is narrow in scope because at common law a shareholder has a personal right to commence proceedings for breaches of the provisions of the memorandum and articles of association conferring special and personal rights on him and under the traditional exceptions[15] to the rule in *Foss v.*

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[13] See Robert R. Pennington, ed., *Pennington's Company Law*,7th ed., (London: Butterworths, 1995) at 867.

[14] See O. A. Osunbor, "The Enforcement of Directors' Duties-New Dimensions in The Companies and Allied Matters Decree 1990" (A Paper Presented at a Workshop on 'Issues of Corporate Management and Finance in the Companies and Allied Matters Decree 1990' at Obafemi Awolowo University, Ile-Ife, Nigeria, held from 19th-21st March, 1991) (Unpublished) at 6-9.

[15] These traditional common law exceptions are already discussed in paragraph IV of Chapter 2 of this paper. See generally *Edwards v Halliwell,* [1950] 2 All E.R. 1064 at 1066-1069 (C.A.); *Prudential Assurance Co Ltd. v Newman Industries Ltd. (No. 2),* [1982] Ch. 204 (C.A.).

Harbottle,[16] which are now incorporated into section 300 of the CAMA. In the words of Osunbor:

> However s.301 appears to imply that a personal action can be employed only in respect of a right due to him personally.....If this is the true purport of the section then it is unduly restrictive of the freedom of a member to maintain a personal action, not only where the right sought to be enforced is personal to himself (e.g. to enforce his class right, his right to dividend and to vote) but also to restrain the company from engaging in an illegal or *ultra vires* act-obviously, non-personal matters.[17]

Section 41(1) of the CAMA dealing with the statutory contract provides that:

> Subject to the provisions of this Decree, the memorandum and articles, when registered, shall have the effect of a contract under seal between the company and its members and officers and between the members and officers themselves whereby they agree to observe and perform the provisions of the memorandum and articles, as altered from time to time in so far as they relate to the company, members, or officers as such.

This creates a statutory contract under seal between the company, its members and officers under which the provisions of the memorandum and articles are enforceable by any of the parties,[18] and on this the Nigerian Law Reform Commission noted:

> Where, therefore, there has been a violation of the rights which accrue personally to the shareholder under the memorandum and articles, such as the right to vote, to share in the dividends, etc, he is entitled to bring an action in his own name.[19]

Thus any breach of the provisions covered by the statutory contract will lead to a personal action even if such is not a personal injury to the shareholder within section 301(1) of the CAMA. Furthermore section 301(1) of the CAMA appears to distinguish between personal

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[16] (1843), 2 Hare 461; 67 E.R. 189 (Ch. D.).

[17] See O. A. Osunbor, *supra* note 14 at 7.

[18] This, in the opinion of this writer, is the equivalent of the Compliance and Restraining Order provision under s. 240 of the ABCA.

[19] *Nigerian Law Reform Commission's Working Papers on the Reform of Nigerian Company Law* (Review and Recommendations) Vol. 1 (Lagos: NRLC, 1988) at 236-237 and at para. 16.

and derivative actions based on the nature of the remedy available. This is that the shareholder shall only be entitled to a declaration or an injunction but not to an award of damages. However, Professor Osunbor does not totally agree with this view:

> ...it may be safer to construe section 301 as spelling out, not the form of action to be adopted in any particular situation, but what remedy the court may grant...[T]he remedy open to the court is a declaration or injunction to restrain the company and/or the directors from doing any particular act and not to make an award of damages.[20]

The rationale behind section 301(1) of the CAMA was to prevent the court from making business decisions on behalf of the corporation and to avoid judicial declaration of dividends. It will then be appropriate that where the directors have, for example, refused to award dividend to a certain shareholder when other shareholders in his class have collected theirs, all that the private shareholder can do is to ask for a declaratory order or an injunction directing the board or the controlling majority to act properly. In this way, the court has maintained its sanctity by refraining from making a dividend award in place of the board while at the same time its order has led to an indirect damages award to the shareholder.

The remedy available, perhaps, is a factor to be considered as an additional complimentary characteristic of a personal action at its conclusion, but it should definitely not be the sole determining factor. The writer submits that section 301(1) of the CAMA be amended to state that a personal action is available to the shareholder not only to enforce a right due to him personally, but also where there is a breach of any of the provisions of the memorandum and articles of association which affects his personal and special interest in the corporation.

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[20] See O.A. Osunbor, *supra* note 14 at 7.

Canadian case law has evolved three main tests for distinguishing between personal and derivative actions.[21] First, the court may try to identify who suffers the injury between the shareholder and the corporate entity.[22] Second, the court tries to identify whom the duty that has been breached is owed between the shareholder and the company. Third, the court may decide whether the individual shareholder's injury is distinct from the corporation's injury in that it does not occur simply because the corporate injury exists. Distinguishing between personal and derivative actions has been topical in the Canadian corporation jurisprudence as was noted by Dennis Peterson:

> The personal action allows rights directly held by a corporate shareholder to be vindicated. Where the parties involved are the corporation and a non-shareholder, it is usually clear that the action is a personal one because the rights generally arise from a contract or deed made between the corporation and the party in question....The situation is not always so clear in the case of a shareholder and the corporation...[i]t may be difficult to determine whether the shareholder is vindicating a personal right or a right obtained derivatively from the corporation.[23]

For example in *Farnham v. Fingold,*[24] the plaintiffs alleged that the controlling shareholders had solicited a premium for their own shares during the sale of a block of shares and bargaining, breached their duties by revealing some confidential information during the time, and wrongly benefitted through insider trading. The defendants moved for an order to dismiss the plaintiff's claim on the ground that it disclosed no cause of action. At the lower

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[21] See Dennis H. Peterson, *Shareholder Remedies in Canada,* (Toronto: Butterworths, 1989) at 17.29-17.37 and at paras 17.55- 17.69; M. Baxter, "The Derivative Action Under the Ontario Business Corporations Act: A Review of Section 97" (1982) 27 McGill L. J. 453 at 457-459.

[22] See *Goldex Mines v. Revill,* [1973] 3 O.R. 869 (Ont. Div. Ct.); *rev'g* [1973] 1 O.R. 659; *aff'd* (1974), 7 O.R. (2d) 216 (Ont. C. A.).

[23] See D.H. Peterson, *supra* note 21 at 17.29 and at para. 17.55.

[24] [1973] 2 O. R. 132, 33 D. L. R. (3d) 156 (Ont. C. A.); *rev'g* on other grounds [1972] 3 O. R. 688 (Ont. H. C.).

court, [25] Morand, J. held that the rights of the plaintiff were personal and so allowed the action without the leave of the court. However the Court of Appeal overturned the decision and held *inter alia* that an action for a declaration that the controlling shareholders were holding the premium obtained for the sale of their shares in the corporation over the market price "for the benefit of the corporation and/or the general shareholders and/or the vendors of such shares" contained intermingled derivative and personal grounds. Since the plaintiff did not obtain leave to commence the action it was fatal to his standing, the court stated:

> Certain parts of the statement of claim and in particular all or parts of paras.......are concerned with rights, duties or obligations owed to the defendant Slater Steel Industries Limited or with damage alleged to be suffered by that corporation as a result of the actions of the other defendants. Such matters are properly the subject of a derivative action rather than a class action.[26]

Further in *Goldex Mines Ltd. v. Revill et. al.*,[27] the court took it on to examine the difference between corporate injuries leading either to personal or derivative actions, by asking this question: "where the same acts of directors or of shareholders cause damage to the company and also to shareholders or a class of them, is a shareholder's cause of action for the wrong done to him derivative?"[28] The court answered that in such situations, both the corporation and the individual shareholder have their separate causes of action:

> In one sense every injury to a company is indirectly an injury to its shareholders. On the other hand, if one applies the test:'is this wrongful act one in respect of which the company could sue?,' a shareholder who is personally and directly injured must surely be entitled to say, as a

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[25] [1972] 3 O.R. 688 (Ont. H.C.).

[26] Per Jessup, J.A. in *Farnham v. Fingold,* [1973], 33 D.L.R. (3d) 156 at 158-159 (Ont. C.A.).

[27] [1973] 3 O.R. 869 (Ont. Div. Ct.); *rev'g* [1973] 1 O.R. 659; *aff'd* [1974] 7 O.R. (2d) 216 (Ont. C.A.).

[28] *Ibid.* [1974] 7 O.R. (2d) 216 at 220 (Ont. C. A.).

matter of logic, 'the company cannot sue for *my* injury; it can only sue for its own.'[29]

In essence, where the injury harms the shareholder *directly* and *personally* he has a personal right of action notwithstanding the fact that the corporation suffers some injury through the same act. For example, where the directors or the controlling majority fail either to issue adequate notices for general meetings,[30] or to observe the required voting number on the issues before declaring the resolutions passed at the general meetings, or have disregarded the shareholder's request for votes on his proposal without valid reasons, or have failed to record the shareholder's vote,[31] or did not allow his proxy to vote under sections 230 and 135 of the CAMA and ABCA respectively, such, even though may be classified as a breach of corporate or managerial powers, will amount to personal and direct injury to the shareholder entitling him to sue personally.[32] This will be an answer to the question asked in the first Canadian approach, 'who suffers the injury?' Summarily, where the individual has suffered a direct and personal injury, he is entitled to sue for redress legally as of right. A shareholder can enforce his personal voting rights, compel declaration of dividends where other shareholders have received theirs, enforce rights of redemption, or recover on grounds of fraud. On the other hand, derivative actions are usually actions based on breach of fiduciary and legal competence duties in the form of actions for negligence, waste of corporate assets,

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[29] *Ibid.* at 221.

[30] *Ibid.*; See also CAMA ss 217-221 and ABCA s. 129.

[31] *Pender v. Lushington* (1877), 6 Ch. D. 70 (Ch. D.).

[32] See Stanley M. Beck, "Shareholders' Derivative Action" (1974) 52 Can. Bar Rev. 159.

basic self-dealing, excessive compensation, and usurpation of corporate opportunities.[33]

Using the second parameter as to whom the duty that has been breached is owed, the court will try to ascertain whether the duty breached is owed primarily either to the corporation or to the individual. Under section 117 of the ABCA, the directors owe fiduciary and legal competence duties to the company to act honestly, in good faith, and with due care, skill and diligence in the best interests of the corporation.[34] Where the directors or the controlling shareholders have acted either dishonestly by engaging in wrongful insider trading, or by engaging in self-dealing transactions, or are competing with the corporation, or have otherwise made secret profits with the use of the corporate property or opportunity, such clearly will be breaches of their duties owed to the corporation. But where they have, for example, prevented the shareholder from having access to the corporation's articles, by-laws, or the corporation's unanimous agreement under section 21(2) of the ABCA, or where his right to vote under section 134 of the ABCA has been overriden, the shareholder will have a personal right of action. As it was rightly noted:

> The principle that the majority governs in corporate affairs is fundamental to corporation law, but its corollary is also important-that the majority must act fairly and honestly. Fairness is the touchstone of equitable justice, and when the test of fairness is not met, the equitable jurisdiction of the Court can be invoked to prevent or remedy the injustice which misrepresentation or other dishonesty has caused. The category of cases in which fiduciary duties and obligations arise is not a closed one.[35]

Using the third parameter, the court also tries to ascertain whether the individual's

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[33] Robert Clark, *supra* note 7 at 662-663.

[34] See the previous discussion in paragraph IV of Chapter 1 of this paper for full discussion the directors' fiduciary duties of good faith, care and skill, e.t.c.

[35] *Goldex Mines Ltd. v. Revill,* [1973] 3 O.R. 869 (Ont. Div. Ct.); *rev'g* [1973] 1 O.R. 659; *aff'd* (1974) 7 O.R. (2d) 216 at 224 (Ont. C.A.).

injury is distinct from the corporation's injury in that it does not occur simply because the corporate injury exists. Thus where the plaintiff's main allegation is that the value of his shares have diminished, such will only amount to a breach of the duty to the corporation.[36] As Pennington proposed:

> A consequence of the distinction between personal and corporate rights is that a member cannot bring a personal action for the loss he has suffered by the dimunition in the value of his shares resulting from the breaches by the defendants of provisions of the company's memorandum or articles which do not confer personal rights on members, or from breaches of fiduciary duties owed by the defendants to the company. Even if the member can prove a conspiracy between the defendants to commit the breaches of duty complained of, the dimunition in the value of his shares is merely a reflection of the loss suffered by the company, and the proper remedy is for the company to sue the defendants or, in appropriate circumstances, for a derivative action to be brought.[37]

Where, however, his right is severable from the general corporate wrong, then he has a personal right of action.[38]

The above are the various tests for the individual shareholder to determine whether to sue derivatively and so obtain leave of court or to commence a personal action. It is proposed that where the court finds that the individual is the one owed the duty that has been breached, the right sought to be enforced belongs to him and does not arise from the injury to the corporation. Where the remedy sought is only a declaration or an injunction, then the court should uphold the individual's personal right to sue notwithstanding that the injury occured contemporaneously with injuries suffered by other shareholders or the corporation itself. It is important to note that personal actions may include breach of a fiduciary duty

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[36] See O. A. Osunbor, *supra* note 14 at 7.

[37] See Robert Pennington, *supra* note 13 at 867; see also Paul L. Davies, ed., *Gower's Principles of Modern Company Law*, 6th ed., (London: Sweet & Maxwell, 1997) at 667-669.

[38] See M. Baxter, *supra* note 21 at 457.

owed by majority shareholders to minority shareholders.[39]

In the United States of America, the courts have also faced the same problem. For example in *Kramer v. Western Pacific Funds,*[40] the court held that for a plaintiff to have standing to bring an an individual action, he must be injured *directly* or *independently* of the corporation.[41] Be that as it may, Welch and Turezyn have submitted that:

> More recently, the court...has stated that the rules and principles by which the distinction between derivative and direct claims is drawn are imperfect. While in some circumstances the differences are clear, in other contexts, especially where equitable relief is sought, the distinctions are less clear. Thus, the court suggested that the best way to view these cases may be to consider the remedy that may be appropriate.[42]

Robert Clark has, however, noted that it is possible for the shareholder to transform a derivative suit into a personal action and vice versa. According to him, this is possible for instance, where there is a self-dealing transaction via the sale to the corporation of a grossly over-valued property owned by the controlling shareholder. The minority shareholder may instead of instituting a derivative suit, allege that his voting rights have been impaired. This will be the result where the impugned majority shareholder who ought not to have voted in the ratification of the deal decides to participate in the transaction and voting. Thus the fact

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[39] *Re Little Billy's Restaurant (1977) Ltd.* (1983), 21 B.L.R. 246 (B.C.S.C.).

[40] 546 A.2d 348 at 351(Del. S.C. 1988). Also Edward Welch & Andrew Turezyn, in *Folk on the Delaware General Corporation Law:Fundamentals,*1998 ed., (New York: Aspen Law & Business, 1998) at 816-817, noted that a shareholder may maintain an individual action against the corporation if he has sustained a 'special injury' which may take the form of either a wrong inflicted upon the stockholder or a wrong affecting any particular right that the stockholder is asserting, such as, the right to vote, assert majority control, and premptive rights. And where a stockholder complains of a wrong to the corporation without alleging 'special injury' such as mismanagement leading to depressed market priceof stocks, challenges of executive compensation and wasteful actions, such are derivative claims.

[41] See also *Lipton v. News Intl.,* 514 A.2d 1075 at 1078 (Del. S.C. 1986).

[42] Edward Welch & Andrew Turezyn, *supra* note 40 at 821.

that the wrongdoing majority shareholder voted to ratify the deal instead of abstaining would deprive the minority shareholder of the weight his votes which would have been carried had there been abstention.[43] It is submitted that this may not be possible in Nigeria and Canada where the stockholder's shares are viewed as his personal property which he may vote as he wishes.

However it is safe to follow the suggestion of Dennis Peterson that where it cannot be conclusively determined whether an action is personal or derivative, or where the shareholder is in doubt as to the nature of the action, then leave of the court should be obtained.[44]

III. Derivative Actions and Class/Representative Actions

Class actions are an aggregate of shareholders personal actions. Thus Nemser noted:

> A derivative action is to be distinguished from a class action....The class action, also devised by equity, generally applies where the question is one of common or general interest to many persons constituting a class so numerous as to make it impractical to bring them all before the court; in such situation one or more may sue or defend as representative of all members of the class.[45]

To Bruce Welling class actions can be initiated by the shareholders in situations where:

> Several shareholders may combine their claims, in which case they will be bringing a class action....Here there are two possibilities..(a) if he and all the other shareholders are in precisely the same situation, have all suffered the same wrong and have undifferentiated claims, then he is bringing a class action, which is one type of representative claim, in that he appears representing a class of which he is a member; (b) if, on the other hand, his claims and those of

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[43] Robert Clark, *supra* note 7 at 663-664.

[44] See D. H. Peterson, *supra* note 21 at 17.36 at para. 17.69; M. Baxter, *supra* note 21 at 459.

[45] See Stanley Nemser, "Derivative Actions" in Stuart D. Weschler, ed., *New Directions in Securities Litigation* (New York: Practising Law Institute, 1976) 67 at 69.

the rest of the class are different, but not competing, he may still represent the group...[46]

A class action thus occurs not only where there is unity of claims, but where the shareholders have different, but not competing claims, and such class action commenced by one of them will be a representative action which is still a specie of personal action, provided they arise out of the same transaction.[47] For convenience sake both class and representative actions shall be jointly referred to as class actions in this paper. In Nigeria, section 301(2) of the CAMA provides:

> Where a member institutes a representative action on behalf of himself and other affected members to enforce any rights due to them, he shall not be entitled to any damages but to a declaration or injunction to restrain the company and/or directors from doing a particular act.

This provision is similar to subsection (1) of section 301 of the CAMA which provides for the shareholder's personal action, and thus the same observation as adduced above will be applicable here too. In effect, section 301(2) provides for an aggregation of personal actions of the shareholders. It is important to note that under section 301(3) and (4), the court is empowered to make an award of costs to the shareholder suing in a personal or representative capacity whether or not his action suceeds and also to make an order if it thinks fit that the shareholder should give security for costs. Further under section 302 of the CAMA, such a shareholder is defined to include a personal representative of a deceased member and any person to whom shares have been transferred or transmitted by operation

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[46] See Bruce Welling, *Corporate Law in Canada: The Governing Principles,* 2nd ed., (Toronto: Butterworths, 1991) at 538-539; see also Paul L. Davies, *supra* note 37 at 666.

[47] See Robert Pennington, *supra* note 13 at 869.

of law.[48] According to the Nigerian Law Reform Commission:

> In the strict sense a representative action is used where a number of members having similar interests or rights which have been infringed sue collectively. This form of action can only be employed where the rights infringed are of a personal and common nature. In practice the minority shareholders will sue on their own behalf and the company and the directors and managers must be made defendants to the action.[49]

At common law, the plaintiff in a class action is not an agent for the persons on behalf of whom he is suing, and he can discontinue the action without their consent, and they are bound by any judgment given therein.[50] Traditionally, the general view was that an essential element of a class action is that there must be an identity of interest among all the shareholders, i.e. undifferentiated claims, or where the claims are different, they must not be competing and must arise out of the same transaction. Thus in *Shack v. Matthews Construction Co. Ltd.,*[51] the court held that the although the plaintiff appeared to have brought the action on behalf of other shareholders, the other shareholders were not in the same interest, and for a class action to be properly constituted, the members of the class must have an identity of interest in the result of the action and their interest must not be manifestly opposed to each other. Consequently Laidlaw, J.A. held that for a class action to subsist:

> They must also have identical interest in the result of the action to fall within the scope and application of the rule. The interest of the respondent in the result of this action is manifestly different and opposed to the interest of other shareholders..[52]

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[48] See O. A. Osunbor, *supra* note 14 at 7.

[49] *Nigerian Law Reform Commission's Working Papers on the Reform of Nigerian Company Law,* (Review and Recommendations) Vol. 1 (Lagos: NRLC, 1988) at 237 and at para. 17.

[50] See Robert Pennington, *supra* note 13 at 868-869.

[51] (1962), 33 D.L.R. (2d) 97 (Ont. C.A.).

[52] *Ibid.* per Laidlaw, J. A. at 100.

However, it is important to note that following the decision in *Shack v. Matthews Construction Co. Ltd.*, [53] various Canadian provinces have taken steps to abolish the restrictive "identical interest" requirement in a class action, by widening the provision to cover situations where the shareholders' class action is based on identical issues of facts and law common to the various plaintiffs arising from common facts. The joint plaintiffs need not have identical interests or claims, and all that was necessary was that they should have similar interests based on identical issues of facts and law arising from common facts. In Ontario, under the *Class Proceedings Act,* [54] "common issues" underlying a class action is defined in section 1 as:

> (a) common but not necessarily identical issues of fact, or
>
> (b) common but not necessarily identical issues of law that arise from common but not necessarily identical facts; (*questions communes*). [55]

There is now little emphasis on identical issues or interets in the result of the action for a class action to subsist in most jurisdictions, and so Nigeria is urged to follow suit. A shareholder should have a right to sue either personally, where his rights under the memorandum and articles of association making up the statutory contract under section 41(1)

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[53] (1962), 33 D.L.R. (2d) 97 (Ont. C.A.).

[54] See Ontario *Class Proceedings Act,* R.S.O. 1992 c-B. 28. However Alberta has no Class Proceedings Act, in which case joint shareholders who wish to initiate a class action in Alberta must have identical interests in the results of the action.

[55] See also section 1 of the British Columbia *Class Proceedings Act,* R.S.B.C. 1996 c-50., which provides that "common issues" are (a) common but not identical issues of fact, or (b) common but not identical issues of law that arise from common but not necessarily identical facts. See also Richard R. Lee, "Corporations-Shareholders' Derivative and Direct Actions-Individual Recovery" (1956-57) 35 North Carolina L. Rev. 279; J. R. Macey and G. P. Miller, "Auctioning Class Action and Derivative Suits: A Rejoinder" (1993) 87 NW. U. L. Rev. 458; R. S. Thomas and R. G. Hansen, "Auctioning Class Action and Derivative Lawsuits: A Critical Analysis" (1993) 87 NW. U. L. R.ev. 423.

of the CAMA or as conferred by the articles of association or the corporation's by-laws (under the ABCA) have been breached provided that such claims do not flow solely from the injury to the corporation. He may also commence a class action in conjunction with and on behalf of other shareholders where they have similar interests or different but uncompeting interests arising from the same transaction provided such issues underlying the shareholders' claims are common issues of law or facts even if they do not arise from identical issues of fact. He may decide to commence a derivative action by obtaining leave of court to enforce a corporate right vested on the corporation itself. However, as it has been suggested above, where there is uncertainty as to the nature of the right or interest sought to be enforced, it is appropriate and safer that the member obtains leave of the court.

IV. Derivative Actions and Actions for Relief Based on Oppression and Unfairness

Under sections 311 and 234 of the CAMA and ABCA respectively a shareholder is permitted to commence an action for relief on the grounds that the affairs of the corporation have been conducted in an oppressive, unfair, prejudicial or discriminatory way.[56] According to Bruce Welling, "the oppression sections presuppose an extraordinary situation not foreseen by the parties involved, yet technically covered by the corporate consitution."[57] Similarly, Stanley Beck commented that:

> The oppression remedy...is, beyond question, the broadest, most comprehensive and most open-ended shareholder remedy in the common law world. It is unprecedented in its scope. It is being

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[56] See E.Oladeji Akanki, "Reformulating the Law Against Oppression in Companies" (1990/91) 13,14 &15 The Journal of Private & Property Law 19; Gordon Phillips, ed., *Personal Remedies for Corporate Injuries* (Scarborough: Carswell, 1992) at 447-510; Robert Pennington, *supra* note 13 at 885-908; Paul L. Davies, *supra* note 35 at 735- 752; Bruce Welling, *supra* note 46 at 553-564; V. A. E. Dyer, "Derivative and Oppressive Actions: Are They Mutually Exclusive?" (1993) 1 Roland on Corporate Litigations (No. 2) at 14.

[57] See Bruce Welling, *supra* note 46 at 554.

> applied to a wide variety of situations in public and private companies, and, most importantly, the courts have shown a willingness to carry out the mandate that the legislatures have given to them to fashion remedies for shareholders who complain that they have been dealt with unfairly. The potential for remedy is so broad that I would confidently predict that over the next decade it will result in a fundamental change in the nature of minority shareholders' rights.[58]

Relief on the ground of oppression is purely a personal action, and the shareholder does not need the leave of the court to sue.[59] Where the corporation is large and widely owned, a breach of the duties owed to the corporation via self-dealing, corporate waste, competing with the company, or the appropriation of corporate opportunities may be remedied via a derivative action only. But where the corporation is closely held, such wrongful acts may be taken as "burdensome, harsh and wrongful" within the context of *Elder v. Elder and Watson,*[60] or contrary to the reasonable legitimate expectation of the parties[61] as in *Naneff v.Con-Crete Holdings Ltd.*[62] Thus an overlap between the two remedies in a small closely held company may arise where there has been payment of excessive management fees, unauthorized corporate loans, self-dealing transactions and the charging of unauthorized franchise fees to the company, as any of the above corporate wrong will suffice for an action

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[58] Stanley M. Beck, "Minority Shareholders' Rights in the 1980s" in *Special Lectures of the Law Society of Upper Canada(1982) Corporate Law in the 80s* (Toronto: De Boo Ltd., 1982) at 312. See also Karen C. Ulmer, "Business Issues: The Oppression Remedy" (1989) 53 Sask. L. Rev. 209.

[59] See Stein Gudmundseth and Sandra Draibye, "Derivative Actions" in Gordon Phillips, ed., *Remedies for Corporate Injuries* (Vancouver: Continuing Legal Education, 1993) at 3.1.04; Elizabeth N. Lella, "Oppression Remedy" (Parts 1-2) (1987) 2 S.C.R.R. 54.

[60] (1952), S.C. 49 at 60 (Scott. Sess.).

[61] MacCarthy Tetrault, *Directors' and Officers' Duties and Liabilities in Canada* (Toronto: Butterworths, 1997) at 81.

[62] (1995) 23 O.R. (3d) 481(Ont. C.A.), *rev'g* 19 O.R. (3d) 691 (Ont. Gen. Div.).

founded mainly either on oppression or derivative rights.[63]

Generally, where the injury is to the corporation then the proper step is to commence a derivative proceeding rather than an oppression action. In *Re Goldstream Resources Ltd.; Dicore Resources Ltd. v. Goldstream Resources Ltd. et al.*,[64] the petitioners commenced an action based on the ground of oppression and unfairness in that the majority of the directors in the corporation proposed a private placement of shares that would improperly deprive the petitioners of their majority shareholding and also lead to devaluation. The court held that if shares were put out on devaluation, the injury will be to the company itself, and so an action under unfair prejudice and oppression was improper. According to Spencer, J.:

> ...the allegation that the private placement will put the company's shares out at an undervaluation. Assuming that to be true, any injury caused to a shareholder is indirect. It may decrease the market value of his shares by putting too little into the company's treasury in return for the new placement. But the real injury, if any, is done to the company itself.[65]

Similarly in *Rogers v. Bank of Montreal*,[66] the plaintiffs' action that the defendants had conspired and improperly appointed a receiver for the corporation and purposely caused injury to the plaintiffs was dismissed on the ground that the damage was not direct but consequential to the injury to the corporation which can only be enforced through a derivative

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[63] Scott Turner, "Derivative Actions" in *Shareholders' Remedies* (Materials Prepared for the Continuing Legal Education Seminar, *New Developments in Shareholders' Remedies*, held in Vancouver, B. C. on November 28, 1996.) at 1.1.05.

[64] (1986), 2 B.C.L.R.(2d) 244 (S.C.).

[65] *Ibid.* per Spencer, J. at 247.

[66] (1985), 64 B.C.L.R. 63 (S.C.), *aff'd* (1986), 9 B.C.L.R. (2d) 190 (C.A.).

action.[67]

However the dividing line between the two types of minority actions has not been clearly drawn as was evident in *Re Peterson et al. and Kanata Investments Ltd.et al.*[68] There the controlling shareholder had abused his duty by profiting at the expense of the corporation, a clear case falling under the derivative action procedure. However the British Columbia Supreme Court held that the minority shareholder may apply to court for an order on grounds of oppression or unfair prejudice.[69] Similarly in *Redekop v. Robco Construction Ltd.,*[70] the plaintiff's interest were ordered to be purchased on the ground that the controlling shareholder and director had breached his fiduciary duty to the corporation by having a personal interest in a corporate transaction, failing to make a disclosure and for using the corporation's property to make private secret profit. The court found the controlling member's conduct as oppressive enough to make the plaintiff lose confidence in the smooth running of the corporation's future business. While approving the definition of "oppression" as was laid down by Lord Keith in *Elder v. Elder and Watson,*[71] Meredith, J. held that:

> It is not lack of confidence between shareholders *per se* that brings.. (the oppression relief)... into play, but lack of confidence springing from oppression of a minority by a majority in the management of the company's affairs, and oppression involves, I think, at least an element of lack of probity or fair dealing to a member in the matter of his proprietary rights as a

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[67] See also *Liu v. Sung* (1988), 27 B.C.L.R. (2d) 191 (S.C.), *rev'd* on other grounds in (1991), 57 B.C.L.R. (2d) 299 (C.A.); See generally J. G. MacIntosh, "The Retrospectivity of the Oppression Remedy" (1987/88) 13 Can. Bar L. J. 219.

[68] (1975), 60 D.L.R. (3d) 527 (B.C.S.C.).

[69] *Ibid.* per Toy, J. at 545.

[70] (1978), 7 B.C.L.R. 268 (S.C.).

[71] Per Lord Keith in [1952] S.C. 49 at 60 (Scott. Sess.); see also *Scottish Co-operative Wholesale Society Ltd. v. Meyer,* [1958] 3 All E.R. 66 (H.L.); *Re H.R. Harmer Ltd.,* [1958] 3 All E.R. 689 (C.A.).

> shareholder....Although paid by Robco, Robillard was actively engaged in the affairs of C.F.R. to serve his own interests. However much he felt himself justified in doing so, he was in fact helping himself with the use of Robco's assets, ultimately at the expense of Robco's shareholders. This I think was conduct which could properly be described as burdensome, harsh and as we have seen, wrongful. It was oppressive to the plaintiff as a member of the company. It caused the plaintiff, justifiably, to lose confidence as a result of the oppression.[72]

After a finding that the defendant "was in fact helping himself with the use" of the corporation's assets amounting to an injury to the corporation itself, the court went on to hold that the acts were oppressive. This is a clear case that could have been enforced derivatively and with leave of the court obtained, as the injury is solely to the corporation.

It is also important to note that there are instances where the corporate wrong is both an injury to the corporation and an oppressive act on the shareholder at the same time. In *Furry Creek Timber Corp. v. Laad Ventures Ltd.*,[73] the controlling shareholders issued shares to a corporation in which they had substantial interest leading to a vast devaluation of the plaintiff's shares, an improper dilution of the corporation's shares, and substantial private profits to the controlling majority. The court, in an action based on oppression, held that the petitioner had standing to sue on the ground that such allotment violated the pre-emptive rights requirement under the corporation law, and at the same time was a an oppressive conduct and an act amounting to conflict of interest position. Accordingly, Newbury, J., relying on the authorities cited by MacIntosh,[74] held:

> Furry Creek's allegations concerning conflict of interest and failure to comply with s. 144 are more problematic. Obviously, the duty of a director to act in the best interests of the company is a duty owed to the company and the company may sue in respect of a breach. Can the same

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[72] Per Meredith, J. in *Redekop v. Robco Construction Ltd.* (1978), 7 B.C.L.R. 268 at 276-277 (S.C.).

[73] (1993), 75 B.C.L.R. (2d) 246 (S.C.).

[74] See J. G. MacIntosh, *supra* note 10 at 46-52.

> breach be the basis of a shareholder's oppression action? Although there appear to be authorities in Canada that suggest the derivative action and oppression action are mutually exclusive, I think the better view is that it can, provided the complaining shareholder has been affected by the breach in a manner different from or in addition to the indirect effect on the value of all shareholders'shares generally. This petitioner has certainly been affected differently than the others: if its allegations are true, it is in fact the *only* shareholder in the entire corporate structure that has suffered injury of any kind as a result of the respondents' actions.[75]

As noted above, a breach of the majority or director's fiduciary duty in a small corporation can also amount to a private oppression or injury to the shareholder provided he can demonstrate a special and peculiar direct adverse effect of such act on his own private interest over and above the injuries suffered by other shareholders. This could be likened to the individual suceeding on a claim for damages for public nuisance in torts upon proving special damages different from that suffered by the general public. Further, where such situations occur:

> [I]t may be preferrable to initiate proceedings under the oppression remedy because...it is not necessary to obtain leave of the court to initiate proceedings, there are no concerns that the suit would be defeated by the ratification of the majority...the suit may be brought by way of summary proceedings, and the court has the authority to grant a greater range of relief [for example, under sections 312 and 234(3) of the CAMA and ABCA respectively].[76]

In sum, it is now possible for a shareholder to maintain a derivative and an oppression action at the same time, provided he obtains the leave of the court before commencing the derivative parts of the action.[77]

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[75] Per Newbury, J. in *Furry Creek Timber Corp v. Laad Ventures Ltd.* (1993), 75 B.C.L.R. (2d) 246 at 254 (S.C.).

[76] See Gudmundseth and Draibye, *supra* note 59 at 3.1.04 and at para. 2.

[77] Scott Turner, *supra* note 63 at 1.1.06; See also J. G. MacIntosh, "The Oppression Remedy: Personal or Derivative" (March 1991) 70 Can. Bar Rev. 29; J. G. MacIntosh, "Bad Faith and the Oppression Remedy: Uneasy Marriage, or Amicable Divorce?" (1990) 69 Can. Bar Rev. 276.

V. Conclusion

The above represents an appraisal of the derivative action and other similar minority shareholder actions under the statutory corporation laws, and as previously discussed, care must be taken in drafting the writ and statement of claim to ensure that they clearly reflect the action being initiated. In which case the writ must state whether the action is personal one, a class action, a derivative suit, or one for relief based on oppression and by this avoid a dismissal.[78] While it is certain that the same act that causes an injury to the corporation can also be oppressive to the individual shareholder or amount to personal injuries,[79] it is advisable that where there is a doubt or uncertainty as to the nature of the claim, the safest course is that the shareholder obtains leave of the court.

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[78] Gudmundseth and Draibye, *supra* note 59 at 3.1.04 and at para. 2.

[79] See *Goldex Mines Ltd. v. Revill et al.*, [1973] 3 O.R. 869 (Ont. Div. Ct.); *rev'g* [1973] 1 O.R. 659; *aff'd* (1974), 7 O.R. 216 at 221 (Ont. C.A.); See also Newbury, J. in *Furry Creek Timber Corp. v. Laad Ventures Ltd.* (1993), 75 B.C.L.R. (2d) 246 at 254 (S.C.).

CONCLUSION

This thesis analysed the statutory derivative actions under the Nigerian and Canadian corporation laws against the background of similar provisions in the United States of America. It was not intended to prefer either of the CAMA or the ABCA as being more instructive than the other. Rather the thesis sought to reveal the guidelines and principles behind the courts' interpretation of these corporation statutes over the years in order to achieve corporate democracy, substantial justice and promote the equitable spirit in the statutes and within the corporate group. These above objectives have been pursued via a historical, analytical and comparative approach and consideration of these statutory provisions in this research work.

From the above analysis, it is very clear that neither of the Nigerian or the Canadian (as represented by the ABCA) corporation statute is an all-inclusive, exhaustive and encompassing corporation law for all purposes, and even though there are various basic similarities between the two laws, there are some salient differences also. This writer also submits that while certain more instructive provisions may be adopted by the CAMA from the ABCA and *vice versa*, some outright amendments are necessary to be made in the two corporation statutes.

The amendments to be suggested might be more beneficial to the Nigerian corporation regime, given the tremendous industrial and commercial growth witnessed in the last two decades, the growing emphasis by the successive federal governments on the privatization scheme, and the divestiture of the state's participation in the business and commercial sector of the economy in Nigeria in favour of individual shareholders.

To begin with this writer suggests that the restrictive provisions of section 303 of the CAMA should be enlarged to allow the applicant's right to commence a statutory derivative action not only regarding corporate wrongs occuring in the corporation of which he is a shareholder, but also to cover wrongful acts and breach of directors duties occuring in the company's subsidiaries and affiliate companies in the same circumstances as obtainable under section 231 of the ABCA. This is also line with the state of the law in the United States of America based on the principles of *double derivative* and *triple derivative suits*. And with the previous discussion on the two concepts in mind (e.g. a parent company's shareholder derivative action to redress a wrongful conduct by the directors of subsidiary company based on the concepts of fiduciary obligations and trusts). It is submitted that in cases where there is "sufficient connection" between the applicant and the subsidiary or the affiliated corporation, and/or where financial benefits in the suit will flow to the applicant by virtue of his shareholding in the parent company, then he should be granted leave to initiate the derivative suit.

It is also recommended that the requirement of "control by the wrongdoing directors" as contained in section 303(2)(a) of the CAMA should be expunged. This requirement is not only outdated and restrictive, but also superfluous and unnecessary. While it is a common law legacy, it is very obvious that the law has progressed steadily through the years to show that control by the wrongdoing directors, though a cummulative factor, is not necessary, as such wrongdoers may even be in the background pulling the strings, and may not even be the executive directors (for example where control is exercised through affinity or influence). In addition "control" has been shown to be present not only when it is a legal control, but also

when it is actual, but covert and latent, as can be evidenced through allegiance and affinity. In summary, the Nigerian legislators are enjoined to abrogate this provision in line with the position in America and Canada.

Concerning the ABCA, it is suggested that the definition of a "complainant" in section 231(a) of the ABCA should include the Director (or the Registrar under the ABCA). This is based on the fact there have been proven cases where the facts that constitute clear corporate wrongs or breach of directors duties are not readily available, visible or manifest to the corporators, but which only become known or made clear during the filing of corporate documents and returns with the Director/Registrar. In such situations, then the Director/Registrar as the "corporate ombudsman" should be included in the class of the complainant so as to ensure and achieve corporate democracy, justice and fairness and in order to preserve the integrity of the corporation law as well as the corporate system.

Perhaps the most commendable provision in the CAMA and ABCA which reflects the equitable spirit of the derivative actions is the refusal to adopt the contemporaneous ownership rule as obtainable under the BCCA and in the United States of America business corporation laws. The justification for its use on the ground of diversity jurisdiction is completely absent in Nigeria and Canada. It is thus submitted that where the applicant who was not a shareholder at the time the wrong occurred subsequently acquires such shares as a *bona fide* purchaser for value without knowledge of the wrong, then he should be allowed to commence a derivative action if it is in the corporation's interests (or "best interests" under the CAMA). To refuse him standing will amount to allowing the erring directors to benefit from their wrongs on technical grounds. This is more so given that the benefit from such an

action will accrue generally to the corporation and not to the shareholder himself.

Concerning future amendments to both the CAMA and ABCA, both the Nigerian and the Canadian law makers should make clear provisions for the recognition of the fact that where the directors/managers committed wrongful corporate act, then a derivative action may be initiated not only by the minority shareholders, but by any shareholder or any class of shareholders. In most widely-held companies where there is no single shareholder holding enough bloc of shares to constitute a clear majority, most corporate wrongs are usually committed by the managers and officers rather than by any controlling shareholder, and since there is no clear majority, the executive managers only use the board as a mere rubberstamp to add legality to their acts.

It may also be necessary for the statutes to make express provisions that in certain peculiar and exceptional situations, the commencement of derivative actions should not be limited to the minority shareholders only, but should be available to a majority shareholder against the minority shareholder. For example, it may happen that there are three shareholders in a company with two of them holding 45% each between them, leaving the third shareholder with 10%. It may also happen that this 10% minority shareholder is the president or the chief executive officer as may be the case, in which case he is able to exploit the lack of consensus and trust or the existence of mutual suspicion and rivalry between the two "majority" shareholders to carry out his whims and caprices within the corporation in total disregard of other shareholders' or the corporation's interests. In the above situation, it will clearly be appropriate for the court to grant one of the "majority" shareholder standing to prosecute a derivative action against the "minority" where the latter has breached his duties to the

corporation.

Another notable suggestion to the law reformers is that of the need for an express amendment to the provisions of sections 309(a) and 231(b)(i) of the CAMA and ABCA respectively to provide that past owners of the corporation's securities may be granted leave to commence derivative proceedings provided that such persons can prove that the alleged corporate wrong occured while they were members of the corporation and that they are among the class of persons entitled to share the benefits of the court's award. It would amount to sheer injustice to render such past owners of the corporation's securities ithout any remedy where the wrongful act led to the loss of membership ststus in the first place. The need for such an amendment is butressed by the provisions of sections 304(2)(c) and 233(c) of the CAMA and ABCA respectively providing that the court has a discretionary power to order proceeds payable in a derivative suit to be paid, in whole or in part, directly to the "former" and present security holders of the corporation and not to the corporation itself. This proposed amendment will solve most of the problems being encountered by the courts in trying to set the scope and limit of the time that the former holders of the corporation's securities must fit within in order to obtain leave to commence derivative actions. The above submissions are based on the fact that while there are certain situations in which these former security holders may have been divested of their shares before they know of such corporate wrong. Since the legislature did not intend to make provisions for an unlimited class of past security holders to qualify into the class of complainants. To qualify under the Acts, such persons must stand to benefit from the court's award.

An amendment is also suggested to sections 303(2)(b) and 232(2)(a) of the CAMA

and ABCA respectively which provide that the complainant must give reasonable notice to the corporation's directors of his intention to apply to the court to commence a derivative action. Express and clear provisions in line with the American position which allow for waiver of the notice requirement if such notice will be futile, unnecessary or will constitute mere formality should be inserted. The foundation of derivative actions provisions is in trust, equity and fairness on which the court of chancery itself is founded, and equity will not allow legal formality to defeat substantial justice by insisting on rigid adherence to legalistic procedures. Thus where the wrongdoing directors are in control of the unindependent board, or where the directors are patently interested or implicated in the alleged wrong, or where it is expedient to dispense with the notice requirement in order to avoid an irreparable harm to the corporate entity itself, then the complainant should be able to treat the notice requirement as being futile, unnecessary or unexpedient in such situations.[1] However, in order to curb the abuse that might follow such relaxation of the rule requiring notice to the board, it is suggested that the court should reserve its discretionary right to decide whether the facts of the case demands that notice should be waived, and so grant or refuse leave to the complainant as it deems fit based on the circumstances of each case after full consideration of the facts.

It is also suggested that express provisions should be made in the corporation statutes to give the court express powers to amend the complainant's claims, expunge the offending parts without prejudice to the whole claim, or grant the complainant an adjournment (i.e. an extension of time within which to amend his claim) where his writ and claims on the writ are

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[1] This position is supported by the eminent scholar, Stanley M. Beck, in "The Shareholders' Derivative Action" (1974) 52 Can. Bar Rev. 167 at 202.

not clearly distinguished as to distinctly separate personal claims from corporate claims, or separate corporate wrongs from wrongs amounting to an oppressive or unfair situation.The court should be able to substitute the complainant's claims with the appropriate actions or allow him sufficient time for amendments rather than dismssing such claims outrightly. In other words, the guiding spirit of the court in the application of the statutes should be the desire and intention to enthrone justice and allow the complainant's legitimate claims to be heard on its merits rather than allowing it to be defeated on mere irregularity as to form. As has been previously discussed in this paper, it is always almost difficult to distinguish between personal and corporate wrongs in most situations, and similarly acts constituting an unfair situation may closely resemble corporate wrongs in certain circumstances. Where such is the situation, the courts should be given express discretionary powers in the Acts to do substantial justice as appropriate based on the circumstances of each case, and not to strike out the complainant's claim entirely. Thus where personal and corporate claims are pleaded together with the complainant not having obtained the leave of the court, the court should grant a stay, and direct the complainant to regularize his position. Similarly, where a derivative action is being prosecuted as an action based on relief for unfairness or oppression, the court should grant a stay, and substitute the complainant's claims or grant him sufficient time to regularize his position. However provisions may be made for the award of costs if the defendants are prejudiced by such court orders for a stay and amendment.

Express provisons should be made that in considering whether the action is in the interests of the corporation under sections 303(2)(d) and 232(2)(c) of the CAMA and ABCA respectively (or "the best interest of the company" under the CAMA), the court must apply

the following factors. First, the court must consider the merits of the complainant's claim and decide whether it discloses an arguable *prima facie* case, that is so far as can be judged from the first disclosure an arguable case exists. Second, where there is a motion to dismiss for failure to disclose a cause of action, the court may adopt the American courts approach in considering the business decision of the board's special committee by generally paying deference to the board or committee's business decision. However, in considering the weight to attach to the board's business judgment or the special committee's pretrial motion, the court should adopt the *moderate two-step review* test in use by the American courts. First, the court must consider among other factors the independence, good faith of the board or the special committee, reasonable investigation, the bases for the committee's conclusions, and the procedure adopted. Second, in addition the court must also apply its own independent business judgment by considering the corporation's interest, public policy and the remaining shareholders' interests. These express provisions are meant to prevent situations where the court's decision and its role may be restricted to an administrative tribunal by paying undue deference and obeisance to the board's business judgment. Thus the court will be in a better position to determine which of the parties represents the corporation's best interests barring mere legalistic and technical restrictions.

However, express provisions may also be included that in the last resort, the court may compose its own special committee to decide if the action is in the corporation's best interests. This will give the court an opportunity to avoid making business decisions and at the same time eradicate pro-board biased opinions common with the board appointed committees.

It is also proposed that express provisions should be made in the CAMA and ABCA respectively that the only requirement for a shareholder class action to subsist is that there should be "common issues" among the aggregated claims. Shareholders class actions are also founded in equity, and in effect there should be no strict requirement that there should be identical interests in the result of the action among all the shareholders. Where the corporation's shareholders wish to come together and aggregate their claims in order to initiate a class action, the court should permit their action provided they have "common issues" underlying their class action. Such common issues should be present where either of the following three categories of joint class claims are present. First, where there is an identical interest present among all the shareholders; Second, it should also include cases where the shareholders interests are common but not necessarily identical; And Third, where the shareholders interests are common interests arising from common facts or issues of law even if not arising from identical facts or identical issues of law.

One may ask whether the present provisions are adequate in meeting their objectives, particularly in view of the various procedural requirements that are to be met before the commencement of the shareholder statutory derivative action. It is this writer's opinion that the present statutory provisions have achieved its three major objectives.[2] First, the provisions allow the shareholders to recover property belonging to the corporation and to enforce corporate rights which the company is entitled to but which the directors and management have refused to pursue. The shareholder is now conferred with legal standing to step into the

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[2] MacCarthy Tetrault, *Directors' and Officers' Duties and Liabilities in Canada* (Toronto: Butterworths, 1997) at 70-71.

directors' shoes and is also empowered to recover the company's property and funds from the wrongdoers. Second, the provisions promote managerial responsibility and accountability, by providing the shareholders with the platform to monitor the directors' actions in the exercise of their corporate powers. Three, the provisions have served as the first step in the statutory amendment for the recognition, enthroning and ensuring corporate democracy and justice in Canada and Nigeria.[3]

It is very manifest that apart from the separate personality principle of the corporation, the topical issue in modern corporation laws that will continue to be relevant in almost every decision touching on principles of corporation laws is that of the minority shareholder's right to institute a derivative action to enforce corporate rights. The legislatures in Nigeria and Canada have taken bold steps in making provisions for the shareholder's derivative rights within the last thirty years, and the courts have followed suit in trying to help put these provisions into their most profitable uses. With the above suggested amendments and bearing

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[3] See generally B. Black and R. Kraakman, "A Self-Enforcing Model of Corporation Law" (1996) 109 Harv. L. Rev. 1911; John C. Coffee, Jr. & Donald E. Schwartz, "The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform" (1981) 81 Colum. L. Rev. 261; D. A. Demott, "Oppressed But Not Betrayed: A Comparative Assessment of Canadian Remedies for Minority Shareholders and Other Corporate Constituents" (1993) 56 Law & Contemp. Problems 181; G. M. Fung, "A Common Goal From Two Different Paths: Protection of Minority Shareholders in Delaware and Canada" (1993) 57 Albany L. Rev. 41; Charles J. Goetz, "A Verdict on Corporate Liability Rules and the Derivative Suit: Not Proven" (1985-86) 71 Cornell L. Rev. 344; Leo Herzel, "Stockholder Litigation as an Instrument of Social Policy" in Stuart D. Weschler and Selma Arnold, eds., *Prosecuting and Defending Stockholder Suits* (New York: Practising Law Institute, 1972) at 67; R. J. Jeffrey and G. MacIntosh, "Towards a Distinctive Canadian Corporate Regime" (1991) 29 Osgoode Hall L. J. 863; M. Maloney, "Whither The Statutory Derivative Action?" (1986) 64 Can. Bar Rev. 309; Paul Mayer, "Minority Shareholders in Quebec" (1987) 4 Business & Law 19; J. Olakunle Orojo, "An Overview of the *Companies and Allied Matters Decree* 1990" in E. O. Akanki, ed., *Essays on Company Law* (Lagos: University of Lagos Press, 1992) 1; Patrick Phelan, "Minority Shareholder's Actions: English Common Law and Canadian Statutory Reform" (1981) 19 U. W. O. L. Rev. 153; I. Ramsay, "Corporate Governance, Shareholders' Litigation and the Prospects for a Statutory Derivative Action" (1992) U. of New South Wales L. J. 149; Donald E. Schwartz, "In Praise of Derivative Suits: A Commentary on the Paper of Professors Fischel and Bradley" (1985-86) 71 Cornell L. Rev. 322; R. Smith, "Shareholders' Derivative Suits and Shareholders' Welfare: An Evaluation and Proposal" (1982/83) NW. U. L. Rev. 856.

in mind the equitable origins of these provisions, one can be confident that this area will continue to witness profitable and progressive developments over the years. The sum total is that derivative action provisions are welcome and necessary in our corporation laws. However, it is recommended that they continue to be subject to the courts' regulation and control as opposed to the American conception of derivative rights as being personal to the shareholder which he can enforce without the requirement of the court's leave.

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APPENDIXES

Part A

The Provisions of The Alberta *Business Corporations Act,* S. A., 1981 c B-15, on The Shareholder's Statutory Derivative Actions:

Section 1: (u) security, ...means a share of any class or series of shares or a debt obligation of a corporation and includes a certificate evidencing such a share or debt obligation.

Section 2: (1) For the purposes of this Act,

(a) one body corporate is affiliated with another body corporate if one of them is the subsidiary of the other or both are subsidiaries of the same body corporate or each of them is controlled by the same person, and

(b) if 2 bodies corporate are affiliated with the same body corporate at the same time, they are deemed to be affiliated with each other.

(2) For the purposes of this Act, a body corporate is controlled by a person if

(a) securities of the body corporate to which are attached more than 50% of the votes that may be cast to elect directors of the body corporate are held, other than by way of security only, by or for the benefit of that person, and

(b) the votes attached to those securities are sufficient, if exercised, to elect a majority of the directors of the body corporate.

(3) For the purposes of this Act, a body corporate is the holding body corporate of another if that other body corporate is its subsdiary.

(4) For the purposes of this Act, a body corporate is subsidiary of another body corporate if

(a) it is controlled by

(i) that other,

(ii) that other and one or more bodies corporate, each of which is controlled by that other, or

(iii) 2 or more bodies corporate, each of which is controlled by that other,

or

(b) it is a subsidiary of a body corporate that is that other's subsidiary.

Section 231: In this part,

(a) "action" means an action under this Act or any other law;

(b) "complainant" means

(i) a registered holder or beneficial owner, or a former registered holder or beneficial owner, of a security of a corporation or any of its affiliates,

(ii) a director or an officer or a former director or officer of a corporation or of any of its affiliates, or

(iii) any other person who, in the discretion of the Court, is a proper person to make an application under this Part.

Section: 232: (1) Subject to subsection (2), a complainant may apply to the Court for leave to

(a) bring an action in the name and on behalf of a corporation or any of its subsidiaries, or

(b) intervene in an action to which a corporation or any of its subsidiaries is a party, for the purpose of prosecuting, defending or discontinuing the action on behalf of the corporation or subsidiary.

(2) No leave may be granted under subsection (1) unless the Court is satisfied that

(a) the complainant has given reasonable notice to the directors of the corporation or its subsidiary of his intention to apply to the Court under subsection (1) if the directors of the corporation or its subsidiary do not bring, diligently prosecute, defend or discontinue the action,

(b) the complainant is acting in good faith, and

(c) it appears to be in the interests of the corporation or its subsidiary that the action be brought, prosecuted, defended or discontinued.

Section 233: In connection with an action brought or intervened in under section 232..., the

Court may at any time make any order it thinks fit including, without limiting the generality of the foregoing, any or all of the following:

(a) an order authorizing the complainant or any other person to control the conduct of the action;

(b) an order giving directions for the conduct of the action;

(c) an order directing that any amount adjudged payable by a defendant in the action shall be paid, in whole or in part, directly to the former and present security holders of the corporation or its subsidiary instead of the corporation or its subsidiary;

(d) an order requiring the corporation or its subsidiary to pay reasonable legal fees incurred by the complainant in connection with the action.

Section 235:(1) An application made or an action brought or intervened in under this Part shall not be stayed or dismissed by reason only that it is shown that an alleged breach of a right or duty owed to the corporation or its subsidiary has been or may be approved by the shareholders of the corporation or the subsidiary, but evidence of approval by the shareholders may be taken into account by the Court in making an order under section ....233.

(2) An application made or an action brought or intervened in under this Part shall not be stayed, discontinued, settled or dismissed for want of prosecution without the approval of the Court given on any terms the Court thinks fit and, if the Court determines that the interests of any complainant may be substantially affected by the stay, discontinuance, settlement or dismissal, the Court may order any party to the application or action to give notice to the complainant.

(3) A complainant is not required to give security for costs in any application made or action brought or intervened in under this Part.

(4) In any application made or an action brought or intervened in under this Part, the Court may at any time order the corporation or its subsidiary to pay to the complainant interim costs, including legal fees and disbursements, but the complainant may be held accountable for the interim costs on final disposition of the application or action.

Part B

The Provisions of The Nigerian *Companies and Allied Matters Act*, Cap. 59, Laws of the Federal Republic of Nigeria, 1990, on The Shareholder's Statutory Derivative Actions

Section 303: (1) Subject to the provisions of subsection (2) of this section, an applicant may apply to the court for leave to bring an action in the name or on behalf of a company, or to intervene in an action to which the company is a party, for the purpose of prosecuting, defending or discontinuing the action on behalf of the company.

(2) No action may be brought and no intervention may be made under subsection (1) of this section, unless the court is satisfied that-

(a) the wrongdoers are the directors who are in control, and will not take necessary action;

(b) the applicant has given reasonable notice to the directors of the company of his intention to apply to the court under subsection (1) of this section if the directors of the company do not bring, diligently prosecute or defend or discontinue the action;

(c) the applicant is acting in good faith;

(d) it appears to be in the best interest of the company that the action be brought, prosecuted, defended or discontinued.

Section 304: (1) In connection with an action brought or intervened under section 303, the court may at any time make any such order or orders, as it thinks fit.

(2) Without prejudice to the generality of subsection (1) of this section, the court may make one or more of the following orders, that is an order-

(a) authorising the applicant or any other person to control the conduct of the action;

(b) giving directions for the conduct of the action;

(c) directing that any amount adjudged payable by a defendant in the action shall be paid, in whole or in part, directly to the former or present security holders of the company instead of to the company;

(d) requiring the company to pay reasonable legal fees incurred by the applicant in connection with the proceedings.

Section 305: An application made or an action brought or intervened in under section 303 of this Decree shall not be stayed or dismissed by reason only that it is shown that an alleged breach of a right or a duty owed to the company has been or may be approved by the shareholders of such company, but evidence of approval by the shareholders may be taken into account in making an order under section 304 of this Decree.

Section 306: An application made or an action brought or intervened in under section 303 of this Decree shall not be stayed, discontinued, settled or dismissed for want of prosecution without the approval of the court given upon such terms as the court thinks fit and, if the court determines that the rights of any applicant may be substantially affected by such stay, discontinuance, settlement or dismissal, the court may order any party to the application or action to give notice to the applicant.

Section 307: An applicant shall not be required to give security for costs in any application made or action brought or intervened in under section 303 of this Decree.

Section 308: In an application made or an action brought or intervened in under section 303 of this Decree, the court may at any time order the company to pay to the applicant interim costs before the final disposition of the application or action.

Section 309: In sections 303 to 308 of this Decree, "applicant" means-

(a) a registered holder or a beneficial owner and a former registered holder or beneficial owner, of a security of a company;

(b) a director or an officer or a former director or officer of a company;

(c) the Commission; or

(d) any other person who in the discretion of the court, is a proper person to make an application under section 303 of this Decree.

Section 650: (1) "securities" include shares, debentures, debenture stock, bonds, notes (other than promissory notes), and units under a unit trust scheme.